No. 10390

In the United States Circuit Court of Appeals

For the Ninth Circuit

AGNES C. JACOB, Petitioner,
vs.
COMMISSIONER OF INTERNAL REVENUE, Respondent.

SHIRLEY MAY JACOB, Petitioner,
vs.
COMMISSIONER OF INTERNAL REVENUE, Respondent.

BEVERLEY JEAN JACOB, Petitioner,
vs.
COMMISSIONER OF INTERNAL REVENUE, Respondent.

GWENDOLYN E. JACOB, Petitioner,
vs.
COMMISSIONER OF INTERNAL REVENUE, Respondent.

PETITIONERS' BRIEF

On Appeal from the District Court of the United States for the District of Oregon.

S. J. BISCHOFF
Public Service Building
Portland, Oregon
Attorney for Petitioners.

FILED
MAY - 3 1943
PAUL P. O'BRIEN,
CLERK

STEVENS-NESS LAW PUB. CO., PORTLAND

SUBJECT INDEX

Page

Statement as to Jurisdiction 1

Statement of Case and Questions Involved 2

Specification of Errors 4

Point I—

Under Section 272(f) of the Revenue Act respondent was without jurisdiction to initiate and the court below to determine this transferee proceeding because jurisdiction had been exhausted by a prior transferee proceeding involving the same taxable year 6

Point II—

There is no substantial evidence in the record to support a finding that petitioners are transferees of the alleged "trust fund" being followed in this proceeding. The record establishes without contradiction or impeachment that the receipt of the fund by Robert T. Jacob (assuming it was a liquidating dividend) was not for petitioners. He received and retained it as his own in derogation of, and adversely to any interest of petitioners 10

Point III—

The Court below erred in admitting in evidence respondent's Exhibit (K): and in giving effect thereto as evidence against petitioners and predicating its determination thereon 29

Point IV—

Respondent is estopped to assert that petition-

SUBJECT INDEX
(Continued)

Page

ers are transferees, by prior inconsistent determinations 32

Point V—

The Court below erred in holding that the fund received by Jacob was a liquidating dividend and in refusing to hold that he received the said fund from E. W. Barnes as payment for the stock sold to him........ 40

Point VI—

There is no finding of fact that respondent exhausted the available remedies against the taxpayer and there is no competent evidence in the record that would sustain such a finding. Transferee liability cannot be imposed until all remedies are exhausted to collect the tax liability out of the taxpayer's property.

The Court below committed error in the admission of hearsay and incompetent evidence with respect to efforts of the Collector to exhaust remedies against the taxpayer........ 56

Point VII—

There is no substantial evidence to sustain a finding that Central Holding Co. was insolvent or rendered insolvent at the time of (a) the alleged transfer, or (b) at the time the transferee proceedings were commenced........ 65

Conclusion 72

TABLE OF CASES

Page

Allan vs. Hendrick, 104 Or. 202 27

Brainard v. Commissioner, 91 F. (2d) 880 (7th Cir.) 22
Apx. 3

Burke v. Commissioner, 21 B.T.A. 45 24

Com. v. Oswego Falls Corp., 71 Fed. (2d) 673 (Second Cir.) 12, 63
Apx. 29

Comm. v. Southern Bell Tel. & Tel. Co., 102 F. (2d) 397 (6th Cir.) 51, 52

Commissioner v. Wilson, 60 F. (2d) 501 (10th Cir.) 8

Dudley v. Commissioner, 15 B.T.A. 570 51

Ford Motor Co. v. U. S., 9 Fed. Suppl. 590 (Ct. of Cl.), cert. den. 296 U.S. 636 38

Gleichman v. Comm., 17 B.T.A. 147 64
Apx. 30

Gregory v. Commissioner, 293 U.S. 465, 55 S. Ct. 266 55

Grosz vs. Grosz, 151 Or. 438 27

Hancock (John) Mutual Life Insurance Co. v. Helvering, 128 F. (2d) 745 23

Harjo v. Commissioner, 34 B.T.A. 467 25

Harvard v. Commissioner, 25 B.T.A. 1161 .... 51, 52
Apx. 35

Higley v. Comm., 69 F. (2d) 160 (8th Cir.) 23
Apx. 1

Howbert v. Penrose, 38 F. (2d) 577 (10th Cir.) 39

King v. Bates, 45 N.W. 147 (Mich.) 61

Kjensbek v. Charity Board, 125 Or. 358 27

Lehigh Valley Trust Co., Executor v. Commissioner, 34 B.T.A. 528, 534 66

TABLE OF CASES

(Continued)

Page

McCall v. Comm., 26 B.T.A. 292 64
Apx. 33

Miller vs. Medford National Bank, 115 Or. 366 27

Morrison v. Covington, 100 So. 124 (Ala.) 61

Morsman v. Commissioner, 90 Fed. (2d) 18 (8th Cir.) 28
Apx. 35

National City Bank v. Comm., 35 B.T.A. 999, aff'd 98 F. (2d) 93 (2nd Cir.) 20

Olson v. Commissioner, 24 B.T.A. 702, aff'd 67 Fed. (2d) 726 (7th Cir.) 19

Phillips-Jones Corporation v. Parmley, 302 U.S. 233 12

Robinson v. Commissioner, 22 B.T.A. 395 51

Rock Island etc. R. Co. v. U. S., 254 U.S. 141 39

Rolnick v. Commissioner, 20 B.T.A. 989 .... 51, 53

Ross v. Comm., 43 B.T.A. 1155 23
Apx. 36

Rossi v. Comm., 41 B.T.A. 734, 739 .... 13, 21

Sanford v. Edwards, 47 Pac. 212 (Mont.) 61

Spellman vs. Sullivan, 43 Fed. (2d) 762; aff'd 61 Fed. (2d) 787 12

Sturtevant Co. v. Commissioner, 47 B.T.A. case No. 56, August 5, 1942 55

Tait, Collector of Internal Revenue v. Western Maryland Railway Co., 289 U.S. 620—53 S. Ct. Rep. 706 37
Apx. 10

Temoyan v. Commissioner, 16 B.T.A. 923 12

Terrace Corp. v. Comm., 37 B.T.A. 263 .... 63, 66
Apx. 24, 29

Troll v. Comm., 33 B.T.A. 598-604 .... 12, 64, 67
Apx. 31

TABLE OF CASES

(Continued)

Page

U. S. v. Best, 19 F. Suppl. 361 (D.C. Mass.) 25

U. S. v. Boss & Peake Auto Co., 285 Fed. 410 (Or.) aff'd 290 Fed. 167 (9th Cir.) 47, 50, 51, 54
Apx. 18

U. S. v. Brown, 86 F. (2d) 798 (6th Cir.) 37
Apx. 15

U. S. v. Lane, 26 F. (2d) 830 (D.C.W.D. of Ky.) 12

U. S. v. Moser, 266 U.S. 236, 45 S. Ct. Rep. 66 38
Apx. 14

Waite v. Grubby, 43 Or. 406 27

Weil v. Commissioner, 31 B.T.A. 899, aff'd 82 Fed. (2d) 561 (5th Cir.); cert. den. 299 U.S. 552 .... 26, 28, 30
Apx. 4

Whitney vs. Commissioner of Internal Revenue, 26 B.T.A. 212 13

Wire Wheel Corporation of America v. Commissioner, 16 B.T.A. 737-741, aff'd 46 F. (2d) 1013.. 63
Apx. 27

Wray v. Commissioner, 24 B.T.A. 94 67

Wright v. Commissioner, 28 B.T.A. 543 25

STATUTES

	Page
Section 311(a)(1), Revenue Act of 1936	1, 7
26 U.S.C.A., Sec. 1115	11
26 U.S.C.A., Sec. 1141	1
26 U.S.C.A., Sec. 3615 and 3654	57, 62
26 U.S.C.A. 112(f)	69
Sections 271 and 272 of the Revenue Act	6, 7

TEXTS

2 C. J. 935	31
22 C.J. 112	75
28 C.J. 630	28
50 C.J. 573	61
65 C.J. 240	28
65 C.J. 378	28
Mertens on the Law of Federal Income Taxation, 1943 Edition, Vol. 9, Sec. 53.06	7, 8, 13
Restatement of the Law of Trusts, Sec. 75	26 Apx. 2
12 R.C.L. 951, Sec. 26	28 Apx. 34
26 R.C.L. 1185, Sec. 21	28 Apx. 34

No. 10390

In the United States
Circuit Court of Appeals
For the Ninth Circuit

AGNES C. JACOB, Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

SHIRLEY MAY JACOB, Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

BEVERLEY JEAN JACOB, Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

GWENDOLYN E. JACOB, Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

PETITIONERS' BRIEF

On Appeal from the Circuit Court of the United States
for the District of Oregon.

STATEMENT AS TO JURISDICTION OF THE TAX COURT OF THE UNITED STATES AND THIS COURT.

On April 8, 1941, respondent mailed to petitioners notices of intention to assess against Agnes C. Jacob an income tax of $2693.68 and excess profits tax of $2207.62, and against each of the other three petitioners income tax of $2805.92 and excess profits tax of $2299.60 as "transferees or transferees of a transferee" of assets of Central Holding Co. (taxpayer) (Tr. pp. 19-20). Said proceedings were instituted under **Section 311(a)(1) of the Revenue Act of 1936.**

On July 2, 1941, petitioners filed with the Tax Court of the United States their petitions for review of the liabilities assessed against them. (Tr. pp. 3 to 55.)

On October 2, 1942, the Tax Court made and entered its final decisions in said proceedings in favor of the respondent (Tr. p. 102).

On December 28, 1942, appellants filed with the Tax Court of the United States their petitions to review the said decisions (Tr. pp. 103-112) and notice of filing of said petitions was duly given to respondent on December 28, 1942. (Tr. p. 112)

Jurisdiction to hear and determine said petitions for review is conferred on this court by **Title 26 U.S.C. A., Sec. 1141.**

STATEMENT OF THE CASE AND QUESTIONS INVOLVED

Central Holding Co., a corporation (taxpayer) was the owner and operator of a hotel at Burns, Oregon. It became liable for $6,007.82 plus interest for income tax for the fiscal year ended June 30, 1938. It filed its return September 15, 1938 but failed to pay the tax disclosed thereby.

These transferee proceedings were instituted against petitioners to impose upon them liability for that tax on the alleged ground that they were transferees of assets of the corporation.

Respondent contends that petitioners (wife and daughters of Robert T. Jacob) were stockholders of the taxpayer and as such are transferees of a fund ($20,422.10) alleged to have been **received for them by Robert T. Jacob** on August 12 and August 18, 1937, as a liquidating dividend and that the corporation was rendered insolvent.

Petitioners contend (1) that they never became stockholders of the corporation; (2) that Jacob was at all times the stockholder; (3) that he received and retained the fund as his own; (4) that he had merely promised to make a gift of stock (not the fund derived from its disposition) to them but never consummated the gift and abandoned his purpose and intention; (5) that he did not receive the fund at their request or with their knowledge or for them; (6) that he never turned

over the fund to them, directly or indirectly or set it apart for them or held it in trust for them; (7) that Jacob did not receive the fund from the taxpayer as a liquidating dividend or at all, but **received it from E. W. Barnes** in payment for his stock in the corporation which he sold to Barnes; (8) that the taxpayer did not become a liquidated corporation. It was not dissolved but continued in existence and to function and operate as such and bought and operated hotel property thereafter; (9) that the corporation was not rendered insolvent; (10) that respondent did not exhaust his remedies against the taxpayer before instituting these transferee proceedings and if he had done so the tax liability could have been satisfied out of assets of the corporation.

Petitioners also contend that respondent is now estopped from asserting that they are transferees of that fund (assuming that it was a liquidating dividend), **first,** by reason of a prior determination **made by the respondent** that petitioners were not the transferees and that Robert T. Jacob was the transferee and, **second,** by a prior determination made by the Board of Tax Appeals in a transferee proceeding prosecuted against Jacob in which the respondent contended and the Board determined that **Jacob was the transferee.**

SPECIFICATION OF ERRORS

I.

The Court below erred in imposing transferee liability on petitioners because the respondent had exhausted jurisdiction to initiate, and the court below to determine, such a proceeding by prior transferee proceeding involving the same taxable year.

II.

The Court below erred in imposing transferee liability on petitioners because;

(a) The uncontradicted and unimpeached evidence is that Robert T. Jacob alone received and retained the fund as his own under a claim of right and in derogation of any interest petitioners might have therein.

(b) Jacob could not **voluntarily** make himself agent or trustee for petitioners and thereby impose personal liability upon them by reason of the receipt and retention of the fund by him.

III.

The Court below erred in holding that the corporation, Central Holding Co., was liquidated, that Jacob received the fund in question as a liquidating dividend; and in refusing to hold that the transaction was a sale of the stock by Jacob to Barnes, and that he received the $20,422.10 from Barnes in payment therefor.

IV.

The Court below erred in holding that the Central Holding Co. became insolvent.

V.

The Court below erred in holding petitioners as transferees without a finding of fact that respondent exhausted his remedies against the taxpayer and there is no substantial evidence in the record to sustain such a finding.

VI.

The Court below erred in holding that respondent was not estopped from proceeding against petitioners as alleged transferees by the prior determinations.

VII.

The Court below erred in admitting in evidence respondent's Exhibit K (Tr. p. 129) over petitioners' objection.

The objection to the introduction of this exhibit was as follows:

> "The Petitioners object to the document signed by R. T. Jacob, which purports to be for the petitioners, on the ground that it is not binding on the Petitioners, and there is no evidence of authority to execute a receipt or receive money on their behalf, or that it was done pursuant to authority."

The objection was overruled and exception was taken. (Tr. p. 129)

VIII.

The Court below erred in permitting the witness Ellison (a deputy collector) to give hearsay testimony of converstions he said he had with other deputies and what they told him in reference to their attempts to ascertain property of the corporation which could be

subjected to the warrant of distraint (Tr. 146-151-152-153).

The testimony was objected to on the ground that it was hearsay and that the action taken on a warrant of distraint could only be shown by the return and not by parol (Tr. p. 151) and a motion was made to strike the evidence (Tr. p. 153). The objections were overruled; the motion denied and exception was taken thereto. (Tr. p. 153)

IX.

The Court below erred in failing to give effect to the statute which imposes the burden of proof upon the respondent to establish every element essential to a transferee liability.

POINT I.

Under Section 272(f) of the Revenue Act respondent was without jurisdiction to initiate and the court below to determine this transferee proceeding because jurisdiction had been exhausted by a prior transferee proceeding involving the same taxable year.

SUMMARY OF THE ARGUMENT

The transferee liability for the entire "table year" must be enforced in a single proceeding. If a notice of assessment was given for a **part** of the transferee liability for the taxable year in question, and a petition was filed with the Tax Court to review the assessment,

no further transferee proceedings could be prosecuted for another part of the tax for the same taxable year.

ARGUMENT

Section 311 of the Revenue Act authorizes the assessment and enforcement of transferee liability

> "in the same manner and **subject to** the same provisions and **limitations as in a case of deficiency** in a tax imposed by this title."

The procedure for assessing and determining deficiency in tax is governed by Sections 271 and 272 of the Revenue Act.

Under Section 271 the procedure to assess and determine a deficiency in tax must be initiated by the Commissioner by a notice of assessment commonly called the "deficiency letter". This notice of deficiency is "vital to the Board's jurisdiction" (Merten's Law of Federal Income Taxation, 1943 ed., Vol. 9, p. 200, Sec. 50.10).

Section 272(f) of the Revenue Act (so far as material) provides,

> "If the Commissioner has mailed to the taxpayer notice of a deficiency as provided in subsection (a) of this section, and the taxpayer files a petition with the Board within the time prescribed in such subsection, the Commissioner shall have **no right to determine any additional deficiency in respect of the same taxable year,** except in the case of fraud, and except as provided in subsection (e) of this section, relating to assertion of greater defiicencies before the Board, or in section 273(c), relating to the making of jeopardy assessments."

Subdivision (e) furnishes the explanation for this limitation. This provision gives the Tax Court in the first proceeding initiated, jurisdiction to determine the correct amount of liability if it appears from the record that the correct amount of the liability is greater than the amount asserted in the notice of assessment.

In **Commissioner v. Wilson, 60 F. (2d) 501 (10th Cir.)**, the court, after calling attention to the statutory provisions here referred to and their legislative history, held:

> "In event a petition is filed with the Board, jurisdiction is conferred upon it to increase the deficiency asserted by the Commissioner, and to determine that additional tax or penalties be assessed, if claim therefor is asserted by the Commissioner **before the hearing**. Section 274 (e) of the act (26 U.S.C.A. § 1048c). Reading these statutes together, we find a logical system without overlap: The Commissioner's authority to redetermine a deficiency is plenary until the taxpayer files a petition with the Board; **from that moment on, power over that taxable year is exclusively with the Board, except where a jeopardy assessment is necessary, or in case of fraud."**

Merten's Law of Federal Income Taxation, 1943 ed., Vol. 9, p. 74, says:

> "Once the taxpayer has appealed to the Board and the Board has rendered its decision, no further deficiency of tax for the taxable year in question may be determined or assessed."

The record in this case discloses that a notice of assessment of transferee liability was served on Robert T. Jacob for the two taxable fiscal years ended respectively June 30, 1937 and June 30, 1938. (Tr. p.

22) The assessment for the latter year (ended June 30, 1938), here involved, was for a **portion only** of the taxpayer's tax liability for that taxable year, to-wit, the **deficiency in tax only.** It did not include the tax liability disclosed by the return as filed. Jacob filed with the Tax Court a petition to review the assessment of the transferee liability asserted against him for both years. (Tr. p. 24) Issue was joined and the Tax Court made a determination therein based upon the stipulation of the parties imposing the transferee liability upon the petitioner therein. (Tr. p. 42) **Respondent did not attempt during that proceeding to have the Tax Court determine transferee liability against petitioner for the original tax disclosed by the income tax return for the tax year ended June 30, 1938 and no determination was made thereon.**

The tax liability sought to be imposed on petitioners herein is for the portion of the tax (original disclosed by the return) for the fiscal year ended June 30, 1938, which was not included in the former transferee proceeding.

The transferee liability for that particular year could not be split up into two independent proceedings, one with respect to the **original tax** disclosed by the income tax return as filed, and another with respect to a **deficiency in tax** for that year later determined.

When the respondent assessed and litigated only a portion (deficiency only) of the transferee liability for the taxable year in question, and did not by appropriate proceeding tender any issue before the Board

as to the **original tax**, respondent **exhausted his jurisdiction** to impose transferee liability with respect to the portion that was not included in that proceeding.

All the tax liability for a "taxable year", whether disclosed by the return, or a deficiency later determined, constitutes a single liability for that tax year.

The entire tax liability, including the liability sought to be enforced in this proceeding could have been enforced in the first proceeding because the same alleged trust fund ($20,422.10) was involved and that was more than sufficient to satisfy the entire liability.

POINT II.

There is no substantial evidence in the record to support a finding that petitioners are transferees of the alleged "trust fund" being followed in this proceeding. The record establishes without contradiction or impeachment that the receipt of the fund by Robert T. Jacob (assuming it was a liquidating dividend) was not for petitioners. He received and retained it as his own in derogation of and adversely to any interest of petitioners.

SUMMARY OF ARGUMENT

a.

The burden of proof is on respondent.

b.

A transferee proceeding, like a judgment creditor's

suit, is in rem and only the one who has the res is liable.

c.

Petitioners did not receive the fund. It was received by R. T. Jacob as his own and retained by him under claim of right and not for petitioners.

d.

Petitioners were not the owners of the stock. Jacob only promised to make a gift of the stock to them but did not complete the gift.

e.

An uncompleted gift creates no interest and cannot be converted into a trust in favor of the intended donees.

f.

Jacob could not constitute himself a voluntary agent or trustee for petitioners and thereby impose on them personal liability by his failure or refusal to carry out his intention to make a gift of the stock to them.

g.

Transferee liability cannot be imposed on petitioners merely because they might have a chose in action against Jacob for the stock or proceeds from the disposition thereof.

ARGUMENT

26 U.S.C.A., Sec. 115 provides that:

> "In proceedings before the board the **burden of proof shall be upon the commissioner** to show that a petitioner is liable as a **transferee** of property of a taxpayer . . . ."

In U. S. v. Lane, 26 F. (2d) 830 (D.C. W. D. of Ky.) it was said:

> "The burden is on the government to prove that Lane received this $385,000 **as a stockholder of the corporation.**"

This statute places a "real burden" on the respondent **(Troll vs. Com., 33 B.T.A. 598)** as to every fact on which the "transferee status is to be determined". **(Temoyan vs. Com., 16 B.T.A. 923.)**

A transferee proceeding, like a judgment creditor's suit, is **quasi in rem.** It is here sought to reach a specific fund ($20,422.10) received by Jacob. The question is whether petitioners are transferees of this fund. This is the asset that is being followed and **not the capital stock** of the corporation.

These are not proceedings to impose "personal liability" on principals for the acts of an agent or on beneficiaries for the acts of a trustee. This is a proceeding to follow trust funds. It is a proceeding **"in rem and limited". (Com. v. Oswego Falls Corp., 71 Fed. (2d) 673, Second Circuit.)** We are concerned only with the question, "Who has the res?"

Such proceedings "are directed rather against the thing than the person". **(Spellman vs. Sullivan, 43 Fed. (2d) 762; affd. 61 Fed. (2d) 787.)**

In **Phillips-Jones Corporation v. Parmley, 302 U.S.** 233 (a transferee case), the Supreme Court said:

> "The liability of the stockholders for the taxes was not created by section 280 (same as § 311(a) (1) of

> Revenue Act of 1936). It does not originate in an assessment made thereunder. Long before the enactment it had been settled under the **trust fund doctrine** (see Pierce v. United States, 255 U.S. 398, 402, 403) that if the assets of a corporation are distributed among the stockholders before all its debts are paid, each stockholder is liable severally to creditors, to the extent of the amount received by him;" . . . . . .

In **Mertens on the Law of Federal Income Taxation (1943 edition, Vol. 9, Sec. 53.06)** the writer says:

> "The transferee provisions . . . . merely permit collection . . . . by a summary procedure of his existing liability in law or equity. . . Thus, the **nature and extent of a transferee's liability must be determined by the settled principles of the common law and federal and local statutes.** The liability of a transferee is secondary, not primary."

In **Whitney vs. Commissioner of Internal Revenue, 26 B.T.A. 212,** the Board said:

> "It follows that if a person claimed to be a transferee **has not received property** from the transferor no liability for the tax attaches to him."

We must not confuse the question whether petitioners received the fund, with the question whether Robt. T. Jacob rightfully or wrongfully received and retained the fund as his own; or whether petitioners had an equitable right to recover it from him. **(Rossi v. Commissioner, 41 B.T.A. 734.)**

The court below applied to this case the principles applicable to the latter question and not those applicable to the former.

The facts pertinent to this assignment of error established by uncontradicted and unimpeached testimony and for the most part conceded are as follows:

The corporation issued 300 shares of no par value stock, 100 shares to Barnes, 100 to Conley and 100 to Robt. T. Jacob.

Prior to the formation of the corporation Jacob told petitioners that he would give them his shares of the capital stock of the corporation when it was formed. His daughters were at that time approximately 15, 18, and 20 years of age. Jacob did not, and could not give the members of his family the stock after the corporation was formed because he was under the contractual duty to Farrell, to remain the owner of a majority of the stock. The corporation acquired title to the hotel and continued to operate it from July 1, 1936 until July 15, 1937, when the hotel building was (except for a small portion) destroyed by fire.

The building and contents had been insured for $72,000. Out of the first moneys obtained from the insurance companies the corporation paid the indebtedness to Farrell in the latter part of July, 1937. Jacob thereupon surrendered to Conley and Barnes the 26½ shares which each had theretofore transferred to him. The corporation also paid off all of its obligations.

After the fire the question arose as to whether the hotel should be rebuilt or other hotel property purchased. Barnes wanted to have the hotel rebuilt. Con-

ley was willing to rebuild if it could be done without going into debt, and Jacob wanted to withdraw. The result was that Jacob received in two payments the sum of $20,422.10 and he transferred the 100 shares to E. W. Barnes.

After Jacob returned to Conley and Barnes the 26½ shares belonging to each of them, all of the stock certificates of the three parties were rewritten but not signed at the time. Conley's 100 shares were divided between himself and his wife. Barnes' 100 shares were likewise divided between himself and his wife. Jacob's 100 shares were rewritten as follows: One share to Jacob, 24 shares to his wife, and 25 shares to each of the three daughters. These certificates were made out **(but not signed) about July 30, 1937.** Jacob sent the 4 certificates made out in the name of his wife and three daughters to his wife, who was then vacationing with his three daughters at Seaside, Oregon, with directions that they should sign the blank endorsements on the back of the certificates and return them to him. No explanation was made by Jacob as to the reason therefor, and he gave them no information as to his negotiations or transactions with his associates. The petitioners signed the endorsements and the certificates were returned to Jacob. They were signed on August 10, 1937.

Up to that time Jacob had not given to petitioners any certificates of stock, he had not given them any declaration of trust, nor had he in any manner (except the promise made **prior** to incorporation) communi-

cated to them his intentions with respect thereto. He had not informed them of the negotiations he was carrying on with respect to the disposition of the stock or the moneys he was to receive therefor, and they were in utter ignorance of every phase of the transaction. They merely followed Jacob's direction. There is not the slightest evidence that they had any knowledge of the reason or the purpose thereof.

On August 12, 1937, Jacob received the sum of $2422.10 and he executed the receipt. (Exhibit "K", Tr. p. 130.) He signed the receipt "R. T. Jacob for Agnes C. Jacob, Gwen Jacob, Shirley Jacob and Beverly Jacob."

Petitioners had not theretofore authorized or directed the receipt of the money by Jacob. They did not know that he intended to receive that money, or that he had received it, or that he intended to receipt for it in their name. He did not inform them that he had executed that receipt at any time after its execution. They never participated in the corporate affairs and knew nothing of its affairs. **This money was never turned over to petitioners directly or indirectly and was retained and used by Jacob for his own purposes.**

On August 17, 1937 Jacob received $18,000 in cash from E. W. Barnes. **No receipt for it was executed.** On that date (Barnes says the next day) Jacob delivered to Barnes the 5 certificates totalling 100 shares of stock. **Barnes testified that they were executed on August 18.**

Petitioners had not been informed that Jacob was to receive this $18,000 or that he had sold or was to transfer the stock to Barnes. They had not directed or authorized him to receive this money for their account or at all. They had not authorized or directed him to sell, transfer or otherwise dispose of the stock on their behalf or at all, and were in utter ignorance of the transfer of the stock to Barnes and of the receipt of the money by Jacob.

Jacob did not turn over to petitioners this money or any part thereof, directly or indirectly, neither did he set apart this money as a fund belonging to petitioners. On the contrary, he retained, appropriated and used the money as his own, for his own purposes, and **in complete derogation of any right that the petitioners might have had thereto.**

Jacob testified frankly and freely that he had promised the stock to the members of his family, that he regarded them as the beneficial owners thereof, that he intended them to have the stock, but **he abandoned that purpose because of the changed conditions.** When the promise to give them the stock was made, the children were young. His testimony was as follows: (Tr. p. 185)

> "My reason for not giving my family the money as I intended to give them an interest in a going concern **in the form of stock.** The question of making them **gifts of cash was not within my purpose, and I felt that would be unwise.**"

The stock was never transferred on the books of the company to the petitioners. It was never delivered

to them. When the certificates were sent to them, it was **not for the purpose of delivery** but for the express purpose of signing an endorsement in blank to certificates which had not yet been executed. This was the condition of the certificates when they were delivered to Barnes and Jacob received the money. They were signed on that day or the next.

The petitioners were all called as witnesses by the respondent. They all testified that they never received any part of the fund, directly or indirectly, from Jacob or from any one else. Jacob, called as a witness by the petitioners, testified that although he had intended to make them a gift of the stock (not the money), he did not give them the money directly or indirectly; nor set it apart for them or hold it for them; but received it, used it, and appropriated it as his own, for his own use, and he stated the reason therefor.

Petitioners submit that under these circumstances there is no warrant in law for subjecting them to the **personal liability** which the decision appealed from imposes upon them.

The court below finds the facts to be as testified to by the petitioners and by Jacob, but it fell into two basic errors: **one,** it confused the question of the legal or equitable ownership of the capital **stock** with the question as to who received the **fund** which is the subject matter of this proceeding, and, **two,** it drew the unwarranted and erroneous conclusion that the receipt of the money by Jacob was in legal contemplation the

receipt by petitioners. This erroneous conclusion is summed up near the end of the opinion as follows.

> "The money received by Jacob from Central was received for these petitioners and not for himself."

The conclusion that Jacob received for the petitioners is in turn drawn from another erroneous conclusion, to-wit; that petitioners "were the owners of 99 shares of said stock at the time the fire insurance proceeds were distributed."

The respondent's case is not grounded upon the contention that petitioners **received the fund in fact** but upon the proposition that they received the fund **constructively.** In determining the effect to be given to the receipt of the fund by Jacob and whether it constitutes constructive receipt by petitioners (assuming, without conceding, that transferee liability can be predicated on constructive receipt) it must be remembered that there was **no consensual relation** of principal and agent, master and servant, or trustee and beneficiary between petitioners and Jacob.

In **Olson vs. Commissioner, 24 B.T.A. 702—aff'd 67 Fed. (2d) 726 (7th Cir.),** an employer deposited with a trustee 40 shares of stock each year for five years, to be delivered to an employee (taxpayer) at the end of five years. The stock was delivered at the end of the five years. The question arose whether the employee was taxable on the full amount of 200 shares in the year he received them or 40 shares in each of the five years. The Board rejected the idea that receipt by the

trustee in each year was "constructive receipt" by the taxpayer for tax purposes.

In **National City Bank v. Commissioner, 35 B.T.A. 999, aff'd 98 Fed. (2d) 93 (2d Cir.)**, the court made clear the distinction between cases in which the taxpayer receives property as his own **"under a claim of right"** and cases in which he receives property pursuant to **"an agreed relationship of principal and agent"** and it was held that only in the latter case was the receipt by the agent deemed to be constructive receipt by the principal. In imposing liability upon the taxpayer in that case the court said:

> "The income tax liability must be determined on the basis of what occurred and not on what might have happened."

The principle and distinction recognized in that case is applicable in the case at bar, for here, too, Jacob received the fund **"under a claim of right"** and retained it as such. He certainly did not receive the fund pursuant to an "**agreed** relationship of principal and agent" with petitioners. Here, too, the determination must be based upon "what occurred and not upon what might have happened". What actually occurred was that **Jacob had changed his mind about giving the** stock to his family. He disposed of it and retained the money as his own. He did so for reasons which he, as head of the family, deemed to be justifiable. As long as he retained that fund as his own it was properly taxable as income to him. The Commissioner assessed the tax upon that income to him and he paid it.

The **Circuit Court of Appeals** in affirming the decision in that case said:

> "Although taxes are public duties attached to the ownership of property, the state should be able to exact their performance without being compelled to **take sides in private controversies**. . . .
>
> "It would be intolerable that the tax must be assessed against **both** the putative tortfeasor and the claimant;"

In **Rossi v. Commissioner, 41 B.T.A. 734-739,** an agent who was authorized to collect and disburse moneys for the taxpayer, received money for his principal and appropriated it to his own use. The Commissioner contended that the money received by the agent was constructively received by the taxpayer; that it constituted part of his income and was taxable as such.

The Board held that the money received by the agent could not be deemed taxpayer's income and subject to income tax as such merely because taxpayer has a claim which he could enforce against the agent. It would be taxable income only when he "actually received it." He cannot be taxed on income which he "might never receive'"

Neither can one be a transferee of property he did not and might never receive.

Petitioners never became the owners of the stock. Jacob merely made a **voluntary** promise to make a gift of the stock (not the fund) to petitioners. Petitioners had parted with **no consideration therefor.** Jacob was

merely a volunteer and we submit that he could not by any voluntary action on his part constitute himself an agent or trustee for petitioners without their knowledge and consent and thereby subject them to a personal liability by reason of his own failure or refusal (rightfully or wrongfully) to carry out his original generous impulse.

All that we have in this case is an **uncompleted** gift of the stock, and an abandonment of the purpose and intention to make the gift. It is uniformly held that an uncompleted gift cannot and does not pass any interest to the intended donee in trust or otherwise.

We are not concerned here with the question as to whether petitioners would have a valid cause of action against Jacob for the recovery of the stock or its proceeds. **This is not a controversy between them.**

Assuming, without conceding, that petitioners had acquired some equity in and to the stock, and in and to the fund received by Jacob upon the disposition thereof, petitioners would **merely have a chose in action, a** possible right of recovery from Jacob. Transferee liability cannot be imposed upon them merely because they might be able to recover the fund from Jacob. (**Brainard v. Commissioner, 91 Fed. (2d)** 880, Appendix, p. 3.) This liability could be imposed upon them only after they had recovered the fund from Jacob, for then, only, would they become transferees; assuming of course, that the fund was in law and in fact a liquidating dividend and other elements essential to transferee liability were present.

As long as Jacob retains the fund under claim of right **as his own** and holds it **adversely to petitioners,** they have not come into possession of any asset which was formerly the property of the Central Holding Co. (the taxpayer), whose tax liability is sought to be satisfied in this proceeding. **Jacob alone would be subject to that liability,** and was subjected to transferee liability in the prior proceeding.

In **John Hancock Mutual Life Insurance Company vs. Helvering,** 128 F. (2d) 745, the court held:

> "At the outset this method of collection (by transferee proceeding) not merely requires that the **petitioner shall have the money,** a sum certain, available as in garnishment or escrow . . . ."

Even in the case of an express trust, the beneficiary of trust property cannot be held as a transferee of property received by and in possession of the trustee. The trustee alone would be the transferee. See **Higley v. Commissioner, 69 Fed. (2d) 160 (8th Cir.)** (Text of opinion, Appendix, p. 1.)

In **Ross v. Commissioner, 43 B.T A. 1155:** W. R. Ross, the principal stockholder of the corporation, entered into an oral agreement with Hicks, Pershall and Jameson by which "the stock was considered as having been owned" by the four individuals in certain proportions. Profits were distributed to Ross and the other three individuals in the proportion fixed by the oral agreement. On the books of the company Ross appeared to be the owner of all of the stock except two shares standing in the name of Hicks and Pershall. On dissolution of the corporation all of the **assets were**

paid to Ross except $100.00 apiece to Hicks and Pershall. Transferee liability was asserted against Ross for the **entire amount** received by him. He contended that he was liable, if at all, only for an amount equal to the percentage of stockholding as fixed by the oral agreement. The Board held that **it mattered not whether the 3 other parties were the actual owners of part of the stock. The "controlling fact" was that Ross received the fund and he alone was liable for it.** (See text of opinion in Appendix, p. 36.)

So in the case at bar it is immaterial that Jacob regarded the members of his family as the beneficial owners of the stock. The fact remains that **he personally received** the **money** and, rightfully or wrongfully, retained it and claimed it as his own. Petitioners did not get it, and therefore if there is any transferee liability he alone is liable.

In **Burke v. Commissioner, 21 B.T.A.** 45, the transferee proceeding was against an heir at law of a decedent who had received property on dissolution of a corporation, the property was not actually received by her. The Board held:

> "A petitioner is liable as a transferee only to the extent of the value of property of the taxpayer **received, and since the respondent has not in this case shown that the petitioner, in her individual capacity, has ever received any of the assets of the dissolved corporation, we hold that in such capacity the petitioner is not liable, at law or in equity, for any unpaid taxes of the corporation."**

In **U. S. v. Best, 19 Fed. Suppl. 361 (D.C. Mass.),** the court refused to impose transferee liability on certain stockholders of record of a dissolved corporation because the evidence failed to establish that they actually received the liquidating dividends. The court held that the burden was on the Commissioner to show the stockholder "received funds".

That case also supports the proposition that where the showing made by respondent is consistent with receipt of the fund by Jacob **in his own right** as it is with receipt by him **for petitioners,** there is a **failure of proof** on the part of respondent for he has the burden of establishing the essential fact by a preponderance of the evidence.

In **Wright v. Commissioner,** 28 **B.T.A.** 543, the Board held:

> "There was **no liability** on the part of these petitioners as transferees **until** the **assets** of the decedent's estate had been **distributed to them** and the estate left without means to pay its tax."

In **Harjo v. Commissioner, 34 B.T.A. 467,** the petitioner became entitled to a share of the decedent's (wife's) estate. The estate was probated and his share allotted to him, but there was **no actual distribution to petitioner** because he was an Indian ward of the Government. The fund was retained by the Secretary of the Interior and held by him for the petitioner. The Board denied transferee liability because the fund was in the hands of the Secretary of the Interior.

Jacob did not become a trustee of the stock or money by virtue of the promise he made before the corporation was formed, because it was a gratuitous promise and the property was not in existence when it was made. No trust arose even when the corporation came into existence. (**Sec. 75, Restatement of the Law of Trusts.**) (Text in appendix, p. 2.)

In **Brainard v. Commissioner, 91 Fed. (2d) 880 (7th Cir.)**, the court held that a trust cannot be created in stock to be thereafter acquired where the **promise is gratuitous** and that no trust interest attaches when the stock does come into existence (see text of opinion, Appendix, p. 3).

The case of **Weil v. Commissioner, 31 B.T.A. 899—aff'd 82 F. (2d) 561 (5th Cir.), cert. den. 299 U.S. 552,** the father of four daughters contended that he had made them a gift of certain stock. The evidence disclosed that he had performed a great many acts which demonstrated his intention to make a gift and which were consistent with a completed gift. Upon the facts the case was much stronger than the case at bar. Nevertheless, the Commissioner contended that there was neither a gift or trust because there had been no delivery of stock to such an extent that it could be said that the father had parted with all dominion and control over the stock. He was sustained in that contention by the **Board of Tax Appeals and the Circuit Court of Appeals**. (Summary of the facts and text of opinion in Appendix, p. 4). We respectfully invite attention to the opinions of both courts in that case.

We believe that the case is decisive upon the questions here involved.

Under the law of the state of Oregon petitioners had not acquired either the **stock** or the **money** as a gift from their husband and father, Robert T. Jacob. The law of gifts in the State of Oregon is crystalized in the following cases:

Waite vs. Grubby, 43 Or. 406.
Allan vs. Hendrick, 104 Or. 202.
Miller vs. Medford National Bank, 115 Or. 366.
Grosz vs. Grosz, 151 Or. 438.
Kjensbek vs. Charity Board, 125 Or. 358.

These decisions lay down the rule that the donor "must divest himself of the property"; that the gift must "operate immediately and irrevocably." There must be 'not only a donative intention but also a complete stripping of the donor of dominion or control over the thing given"; that "mere promise without consideration" cannot be converted into a "voluntary trust"; that "there must be a parting of dominion . . . so fully and completely . . . that if the donor again resumes control over it without consent of the donee he becomes a trespasser . . ."; that "the gift must be complete and nothing left undone" and the gift must go into "immediate and absolute effect".

By no stretch of the imagination can it be said that Jacob had carried out his intention, made delivery and completed the gift in the manner and to the extent contemplated by these decisions.

It is also settled that while love and affection may constitute consideration for an **executed** gift, it does **not** constitute consideration to support a **promise** to make a gift or the creation of a voluntary trust. (28 C.J. 130 and 65 C.J. 240.)

The law is also well settled that an uncompleted gift cannot be converted into a trust.

In 65 C.J. 378, the rule is stated as follows:

> "(Sec. 152) 3. **Imperfect Gift.** Equity will not convert an imperfect gift into a declaration of trust, merely on account of such imperfection; and so, where a donor delivers personally to his agent with instructions to give it to a specified donee, which the agent fails to do, such agent is not a trustee of the property for the donee."

The Board of Tax Appeals and the Circuit Courts of Appeal have rejected the idea that an uncompleted gift can be converted into a trust. In **Weil vs. Commissioner, 82 F. (2d) 561 (5th Cir.), cert. denied, 299 U.S. 552, the court held:**

> "The evidence to establish a voluntary express trust in personal property must show a clear intention to create a trust. **Equity will not make one where none has been clearly declared. A defective or imperfect gift will not be converted into a trust.** Elliott v. Gordon, 70 Fed. (2d) 9; Eachen v. Steers, 10 Fed. (2d) 740.

To the same effect are

Morsman v. Commissioner, 90 Fed. (2d) 18 (2d Cir.), Appendix, p. 35.
26 R.C.L. 1185, § 21, Appendix, p. 34.
12 R.C.L. 951, § 26, Appendix, p. 34.

We submit that petitioners should not be penalized because Jacob rightfully or wrongfully abandoned his purpose to make them a gift of the stock or money and retained it as his own.

POINT III.

The court below erred in admitting in evidence respondent's Exhibit (K); and in giving effect thereto as evidence against petitioners and predicating its determination thereon.

SUMMARY OF ARGUMENT

There is on evidence that Jacob was agent for petitioners; that he was authorized by them to receive the money **for them**; or that they authorized him to sign the receipt **for them**; or they had any knowledge of the negotiations between Jacob and Barnes; or that they ever ratified the execution of the receipt by Jacob by receiving the money or in any other manner. Hence, the Court below erred in admitting in evidence the receipt signed by Jacob "for petitioners" and in predicating its decision thereon.

ARGUMENT

Respondent offered in evidence the receipts, Exhibit (K) (Tr. p. 129). The exhibit consisted of three receipts, one signed by Conley, another by Barnes and a third by Jacob (Tr. p. 130). The instrument signed by Jacob (Tr. p. 130) acknowledges the receipt of

$2,422.10 "being one-third of the proceeds of insurance on hand this date. Application of such distribution to be later determined." It is signed: "Robert T. Jacob for Agnes C. Jacob, Gwen Jacob, Shirley Jacob, Beverly Jacob.

Petitioners objected to its introduction in evidence "on the ground that it is not binding upon petitioners and there is no evidence of authority to execute or receive money on their behalf, or that it was done pursuant to authority." The objection was overruled and exception taken (Tr. p. 129).

We submit that the court below committed error in the admission of this receipt. That document could, of course, be used **against Jacob** as a declaration against interest. But it was certainly not binding upon petitioners in the absence of evidence conferring upon Jacob (a) authority to receive money on their behalf, (b) authority to sign the receipt, (c) authority to dispose of the stock for them, or in the alternative evidence of ratification. There is not a scintilla of evidence supplying any of these requirements.

Jacob could not voluntarily make himself petitioners' agent and thereby impose personal liability upon them merely by the abortive intention to make them a gift of the stock.

If they were the owners of the stock, Jacob had no authority to sell it (**Weil v. Commissioner, 82 Fed. (2d) 561 (5th Cir.)**, Appendix, p. 8), and therefore had no authority to execute a receipt for them.

In 2 **Corpus Juris 935**, the rule is stated as follows:

> "The declaration of an alleged agent made to a third person in the absence of the alleged principal, which were not brought to his knowledge or ratified by him, and not supported by other evidence, are not competent against the alleged principal to prove the fact of his agency; and this rule that denies the competency, as against an alleged principal, of declarations of the alleged agent made to a third person in the absence of the alleged principal is particularly applicable where the alleged principal denies the agency, nor are such declarations competent to disprove the agency, or to prove a renewal thereof. . . .
>
> . . . .
>
> "The general rule applies equally to oral statements of the agent, and to written statements contained in letters, letterheads, **receipts** or other documents, implying, admitting, or claiming authority to act as agent in the negotiations with the third person."

The error vitally affected the decision of the court below. It gave the receipt controlling significance and it is a fair inference that without the receipt it would not have reached that conclusion.

The opinion indicates that the court below proceeded as though the issue was between Jacob and the petitioners. It ignored the rule that before petitioners could be charged with Jacob's declarations, respondent had the burden of proving that he was their agent and was acting within the scope of his authority.

Even if petitioners were the beneficial owners of the stock, that would not authorize him to dispose of it, receive money and sign a receipt **for them** without their consent.

Since the court below permitted itself to be influenced by illegal evidence this court must now determine the question by its own appraisal of the record, disregarding the incompetent evidence, and must draw its own conclusion therefrom.

POINT IV. estoppel

Respondent is estopped to assert that petitioners are transferees, by prior inconsistent determinations.

SUMMARY OF ARGUMENT

a.

Respondent made a determination that petitioners were not transferees of the fund in question, when he examined the income tax returns filed by petitioners in which they reported proportionate parts of the fund as their income and they paid tax thereon and he refunded the tax paid by them.

b.

The transferee proceeding initiated and prosecuted to judgment by respondent against Jacob as transferee of the same fund bars this proceeding against petitioners, for it involves the same fund and respondent contended in said proceeding and it was determined that petitioners herein were not transferees of that fund.

c.

Jacob and these petitioners could not be transferees of the same fund.

ARGUMENT

Robert T. Jacob is an attorney whose practice is limited to income tax law. When he received the fund in question he realized that a question would arise as to the tax liability upon the profit derived from the disposition of the stock, because he had promised to make a gift of the stock to petitioners. To avoid any implication of bad faith he reported the receipt of the $20,422.10 as income in **his** personal income tax return and paid a tax thereon. His wife and daughters also reported as income the same fund. Each reported one-fourth in their personal income tax returns and paid a tax thereon. Jacob attached to his return a lengthy explanation as to the reason for reporting and paying the tax on that income twice (see text quoted in full in the opinion, Tr. pp. 79-81).

With the facts thus placed before the respondent he made an investigation and **determined** that the petitioners had **not** received a gift of the stock; that the

> "Stock held to be the income of her (husband)
> (father)"
>
> . . . . . .
>
> "Taxpayer held to have received **proceeds from liquidation** of Central Holding Co. stock **as a gift rather than a gift of stock** certificates."
> (Pet. Exh. 9, Tr. p. 180.)

Respondent refunded the tax paid by petitioners. Thus respondent with knowledge of the facts, made a determination that petitioners were not the owners of the stock.

Since Jacob was the owner of the stock, he received the fund paid therefore **as his own** and not for petitioners. The determination that Jacob later made a gift of the **money** to petitioners has been abandoned.

The determination clearly and definitely held **Jacob** to be the **owner of the stock** and, **therefore,** the **owner of the funds** paid to him as alleged liquidating dividend.

Thereafter respondent instituted a transferee proceeding against Robert T. Jacob involving the same fund (see notice of assessment letter to Robert T. Jacob, Tr. p. 24 and petition, answer and proceedings thereon, Tr. pp. 24-55). Respondent alleged in that proceeding that on August 17, 1937 "the petitioner herein (Robert T. Jacob) was a stockholder in said Central Holding Co.; that as such stockholder and without consideration there was distributed by the Central Holding Co. to the petitioner (Jacob) on to-wit, August 17, 1937, assets and property consisting of cash in the sum of, to-wit, $20,422.10" (Tr. p. 40); that by reason of the premises the petitioner (Jacob) became and now is liable as a transferee of the property of the taxpayer.

During the trial of said proceeding which was tried jointly with the proceeding to determine the deficiency against the taxpayer as well as transferee proceedings against Conley and Barnes, the respondent and all of the petitioners in said proceedings made the stipulation entered of record in open court which is reproduced in full (Tr. pp. 46-49). It was stipulated by respondent and petitioner Jacob that **Jacob was the trans-**

feree (Tr. p. 48). Based upon this stipulation, the Board of Tax Appeals entered its decision that Jacob was "liable as a transferee" for the deficiency in tax assessed against the corporation (Tr. p. 53).

Pursuant to that determination respondent assessed against Jacob the transferee liability and Jacob paid a sum in excess of $9,000.00 in satisfaction thereof (Tr. p. 127).

Thus for the second time, respondent, with knowledge of the facts, determined that Jacob was the transferee and not the petitioners herein and later prosecuted a transferee proceeding against Jacob involving the identical fund and procured a judgment holding Jacob to be a transferee of that fund and liable for the corporation's unpaid income tax.

By these determinations respondent is estopped from again litigating the issue because respondent made an **irrevocable election** and determination to treat Robert T. Jacob as the owner of the stock and the recipient of the alleged liquidating dividend and was therefore transferee, and that the petitioners herein were not the owners of the stock and the recipients of the alleged liquidating dividend.

The first determination resulting in the refund to petitioners was, of course, in a proceeding between the same parties now before the Court. It involved the **same alleged trust fund.** It involved liability for income tax of the Central Holding Co. (taxpayer) for the same year, to-wit: fiscal year ending June 30,

1938, and it involved the same issue, to-wit: Were the petitioners the stockholders of Central Holding Co., and as such did they receive **the fund** in question as a liquidating dividend?

We submit that these determinations, under the authorities which will be presently cited, precludes respondent from now asserting that the petitioners were the "transferees". The only difference in the instant and the former proceeding is that it involved the liability for the **deficiency** in income tax, whereas, in this proceeding there is involved the liability for the **original tax** disclosed by the return. In legal contemplation the deficency and the original tax constitute **a single tax for the year in question.** The liability for both depends upon the identical facts, the same legal status of the parties and the same transaction. **One could not be a transferee so far as the original tax is concerned and not a transferee so far as the deficiency is concerned, or vice versa.** Hence this difference cannot change the legal effect of the former determination.

The parties in the first transferee proceeding and in this proceeding are in legal contemplation the same. It is true the first proceeding was against Jacob and this one is against petitioners. But respondent now charges that Jacob received the fund for them, that he was their agent or trustee, therefore they were in privity and the proceedings are therefore in law between the same parties.

In any event in the two former proceedings as well as in the present proceeding the **crucial issue** is the same, namely whether the specific fund of $20,422.10 was received by Jacob as his own under a claim of ownership or whether it was received by petitioners. This issue is common to all of these proceedings.

The respondent assumes a position **diametrically opposed** to that which he assumed in all former proceedings in so far as he makes the contention that the petitioners are transferees, and we submit that he is precluded from doing so.

In **U. S. v. Brown,** 86 **Fed. (2d) 798 (6th Cir.),** the Court held squarely that the former proceeding **"unequivocally constituted an election"** where the Commissioner first determined that petitioner received the fund as income and imposed income tax thereon and later sought to hold him as a transferee of the same fund. (Summary of facts and opinion, Appendix, p. 15.)

In **Tait, Collector of Internal Revenue v. Western Maryland Railway Co., 289 U.S. 620—53 S. Ct. Rep. 706,** the Supreme Court virtually disposed of all contentions that are advanced in this case with respect to the effect of the prior determinations as an estoppel against the respondent.

We deem that case to be controlling here. The statement of facts in that case and the opinion are too lengthy to be set out or summarized here. Pertinent parts of the opinion are quoted in the Appendix, p. 10.

We respectfully invite the attention of the Court to the full text of the case in 289 U.S. 620. The Court made clear the distinction between "res judicata" and "estoppel by judgment" and the extent to which there need be identity of aprties, subject matter and issues under each doctrine. The principles there enunciated compells the conclusion that respondent is estopped to urge that petitioners are transferees.

The Board refused to give effect to the estoppel because petitioners have not shown that they have in any way been **damaged or mislead to their detriment** by the respondent.

The doctrines of **estoppel by judgment** and **res judicata** are based upon **public policy, not damage or detriment.** The **Supreme Court** so held in the **Tait case.** It said:

> "The public policy upon which the rule is founded has been said to apply with equal force to the sovereign's demand and the claims of private citiens."

In **United States vs. Mosier, 266 U.S. 236,** the Supreme Court pointed out the distinction between res judicata which requires identity of parties and subject matter, and estoppel by judgment in which there need be only identity of issue determined. (See text of opinion, page 14 of Appendix.)

In **Ford Motor Co. v. U. S., 9 Fed. Suppl. 590 (Ct. of Cl.) (Cert. den. 296 U.S. 636),** the court refused to permit the Government to

> "Assign a certain status to a taxpayer for the purpose of collecting taxes and then give it another status in refusing to allow interest."

The Court said:

> "It necessarily follows that they must be regarded and treated on the same basis in all transactions having to do with the adjustment and settlement of such tax liability. If they are separate taxpayers in the assessment and payment of the tax, they cannot be considered and treated as constituting a single taxpayer in respect to overassessments and deficiencies."

So in the case at bar the fund could not be the property of Jacob for his own tax purpose and the property of petitioners for the purpose of transferee liability.

Neither could Jacob be the transferee of the fund for part of the tax liability and petitioners be the transferees of the **same fund** as to another part of the same tax liability.

It has been said that "men must turn square corners when dealing with the government." **(Rock Island Etc. R. Co. v. U. S., 254 U.S. 141)** But there is the reciprocal obligation that "The Government ought to turn square corners when dealing with its citizens". **(Howbert vs. Penrose, 38 F. (2d) 577 (10th Cir.))**. It cannot be said that the government is turning square corners in this case when on the one hand it has assessed an income tax on Jacob on the theory that the fund of $20,422.10 was his property and his income and has imposed upon him ~~income tax~~ because he re-

ceived that property as his own, and **now assert** that after all, Jacob was not the owner of that fund, it was not his income, it was not his property, **he was not a transferee,** but these petitioners, the members of his family were all the time the true owners of the fund and should be held liable as transferees.

If appellants were in law and in fact the transferees of the fund in question, then respondent committed a legal fraud upon Jacob in (a) assessing and collecting from him income tax on the receipt of the fund, and (b) in bringing against him transferee proceedings by reason of the receipt of the same fund, obtaining judgment thereon and collecting and returning the sum in excess of $9000 in payment of the liability so imposed.

POINT V.

The Court below erred in holding that the fund received by Jacob was a liquidating dividend and in refusing to hold that he received the said fund from E. W. Barnes as payment for the stock sold to him.

SUMMARY OF ARGUMENT

The transaction was in fact and in law a sale of stock by Jacob to Barnes and not the distribution of a liquidating dividend. The fact that Barnes either appropriated or borrowed money of the corporation with which to make the purchase, does not convert the transaction into a liquidation of the corporation. If

anyone was a transferee it was Barnes. It was contemplated that the corporation should and it did continue in existence, and to function as such. It bought and operated hotel property after the sale of the stock by Jacob to Barnes.

ARGUMENT

For the purpose of the discussion of this question it is immaterial whether the stock turned over to Barnes was the property of Jacob or of the petitioners. If the transaction was a sale of the stock to Barnes and the money was received from him in payment therefor, it was not a liquidating dividend and neither Jacob or petitioners are liable as transferees.

There is little or no dispute as to what was actually said and done by the parties with respect to the disposition of the Jacob stock. The issue is only as to the legal effect of the transaction.

While the building was on fire, Barnes, who was at Burns, called Conley at Portland by long distance telephone and informed him of the fire. Conley informed Jacob, who was also in Portland, and they discussed briefly the future. Jacob expressed the desire to withdraw from the enterprise if the building was lost. Conley was disposed to rebuild if it could be done without going too much in debt. Conley went to Burns the next day. Barnes wanted to know if Jacob and Conley wanted to rebuild. Conley told Barnes of his conversation with Jacob and reiterated his own position. Barnes said to Conley (p. 135): "If you and

Mr. Jacob step out, will you give me your stock?" Conley said, "I can speak only for myself, and if I step out I will give you my stock and I will ask Mr. Jacob when I go back to Portland". Conley said he asked Jacob and he said he would. In a few days Barnes came to Portland but before coming down he was already engaged in making plans and getting estimates for reconstruction of the hotel. When he came to Portland he discussed the matter with Jacob.

Barnes nowhere purported to testify to the actual conversation that he had with Jacob in Portland. He testified largely to conclusions. He testfied:

> "I asked them if they would give me their stock and they said 'yes' ". (Tr. p. 157)

Jacob testified (Tr. pp. 182 and 183) that when Barnes came to Portland

> "that he planned to rebuild the hotel and he had to be on the ground to make estimates of cost. **He** was planning a new hotel and **wanted to keep the corporation alive** because it would be easier to obtain loans and refinance the construction of the building if he did so and he wanted to know **if he could take me out** and acquire my stock if I didn't want to go ahead and then he said he would take me out if I would transfer by stock to him. . . (Tr. p. 186) He told me specifically he wanted to keep the corporation alive particularly for the convenience in borrowing money . . . . . . I am positive Barnes used the phrase he wanted to take me out, and I interpreted the transaction as consisting of a sale by me of the stock to Barnes."

Barnes was in court when this testimony was given and did not contradict it.

This is the sum total of the testimony as to the conversations which resulted in the transfer.

With respect to the future of the corporation Conley testified as a witness for respondent that "the purpose for which the stock certificates were to be given to Mr. Barnes" was "to vest the ownership of the stock in Mr. Barnes so that he could go ahead and build, or whatever he wanted with the company" (Tr. p. 135). do

Jacob testified that Barnes told him in the aforesaid conversation that (Tr. p. 182) "he was planning a new hotel and wanted to keep the corporation alive because it would be easier to obtain loans and refinance construction of the building."

Barnes himself testified (Tr. p. 159):

> "I would rather have the company anyway because I might want to borrow some money and I could borrow quicker if I had a company."

Before the transaction was concluded they discussed the question of the tax liability for the profit resulting from the receipt of the fire insurance money and they were advised by Jacob that since the corporation was to remain in existence and rebuild the hotel or purchase other hotel property, that no gain or loss would be recognized under the statute governing involuntary conversion of property (Sec. 112(f)) where as if the corporation was liquidated there would be a tax of approximately $3,000.00 on the corporation. The continuation of the corporation and the saving of a tax liability resulting therefrom became a factor in the determination of the amount that Jacob was to

receive for his stock.

After these negotiations Barnes and Conley obtained $18,000.00 upon the settlement of the fire loss by some of the companies. Out of that money they paid off the balance of the indebtedness to Farrell and all other obligations of the corporation. Jacob returned to Conley and Barnes the twenty-six and a half shares which each had formerly turned over to Jacob to be held while the Farrell debt was unpaid.

Conley forwarded $5,000.00 of that insurance money to Barnes at Burns. He opened a bank account in the name of Central Holding Co. with that money. He immediately drew $2800.00 of it and purchased from the County the real property at Hines, Oregon, which had on it and unfinished hotel building. Title was originally taken in the name of Barnes but later transferred to the Central Holding Co.

In the meantime, Barnes was negotiating for a loan of $60,000.00 from the First National Bank at Portland, Oregon, but he was also investigating other hotel property.

Toward the end of July, 1937, and before any payments were made, the stock certificates of all of the parties were rewritten. Conley's holdings were divided between himself and his wife, Barnes' holdings were divided between himself and his wife and the hundred shares of stock in Jacob's name were divided one share to himself, twenty-four shares to his wife, and twenty-five shares to each of his three daughters. All of the certificates were made out but not signed. Jacob sent

the certificates made out in the names of his wife and three daughters to them at Seaside, Oregon, with the direction that they sign the endorsements in blank on the back of the certificates and return to him, which they did.

On August 12, after the Hines property was purchased, Jacob received the sum of $2,422.10 and signed the receipt, Exhibit (K), which recites "application of such distribution to be later determined."

On August 17th, Jacob was requested to meet Conley and Barnes at the First National Bank. He did so. Barnes handed Jacob $18,000 in cash and Jacob turned over to Barnes the five certificates totalling 100 shares. (Barnes says he received them the next day and that the certificates were executed the next day.)

Jacob had not been told that Barnes and Conley had received the $54,000.00 in settlement of the loss by another insurance company prior to or at the time that he received the $18,000.00. He did not know that the $18,000.00 was a part of the insurance money, but assumed that it was. At the time he got the money he handed Barnes a resignation as a director of the company.

The corporation was not dissolved. No resolution was ever adopted authorizing the distribution of any funds or the liquidation of the corporation.

Conley testified: (Tr. p. 137)

"When the stock was delivered the corporation was not dissolved. The corporation continued and in

> December, 1937, purchased another hotel at Arlington, Oregon, which was named the 'Welcome Hotel'. The big neon sign 'Welcome Hotel' was transferred from Burns and put on the hotel at Arlington."

At least $20,422.10 remained in the corporation, Conley testified as a witness for respondent "at least it was left in the company" (Tr. p. 128).

Barnes stated in a letter addressed to Jacob (petitioners' Exhibit 5, Tr. p. 165) "the money that was left in the Central Holding Co. I can account for to the last penny." He testified this had reference to the $20,422.10 (Tr. p. 168), although in his oral testimony he spoke of that money as his own.

In November, 1937, the Central Holding Co. contracted to purchase the Arlington Hotel at Arlington, Oregon, and it took title to the hotel in December, 1937. It changed the name to Welcome Hotel and removed the big neon sign which had been on the Burns property. The Arlington property was bought for $50,000.00. It was paid for as follows: something over $5,000.00 in cash, $15,000.00 by conveyance of the Hines property which the corporation had acquired shortly after the fire, $5,000.00 by the assumption of taxes and a purchase money mortgage for the balance. The cash payment and $4,000.00 which was spent for reconditioning the hotel immediately afterward, was paid out of the $20,422.10 which remained in the corporation as aforesaid. The corporation thereafter continued to own and operate the hotel. The purchase money mortgage was executed by the corporation. The corpora-

tion was dissolved in January of 1941.

The Jacob stock was not surrendered for cancellation nor was it turned into treasury stock. It became the personal property of Barnes or Barnes and his wife. Barnes admitted that it was contemplated by all concerned that the corporation was to continue in existence; that it would continue to engage in the hotel business either by reconstructing the hotel at Burns or the purchase of another hotel property.

Of course it was not essential in order for the transaction to be a purchase and sale of the stock to Barnes that the word "sale" should be used in their conversation or that there should be a bill of sale. A transaction is not judged by the terminology used by either or both parties. The legal effect of what was actually said and done must govern. (**U. S. v. Boss & Peake Auto Co., (9th Cir.)**, a transferee case, Appendix, p. 18).

The inquiry made by Barnes whether he could "take out" Jacob clearly implies a desire by Barnes to purchase and acquire his stock. It does not connote a request that Jacob make a gift of the stock or surrender to the corporation without consideration.

If the language employed is ambiguous, that ambiguity must be resolved against the respondent for the burden of proving the character of the transaction was upon the respondent, particularly so in view of the fact that Barnes did not purport to give any conversation with Jacob upon that important fact.

But whatever ambiguity there may be is dissipated by all of the circumstances and the subsequent conduct of the parties. These are as follows:

The stock was not surrendered to the corporation for cancellation. It was not turned in to the corporation to be held as treasury stock. There was no resolution of the Board of Directors to distribute the money as a liquidating dividend. There was no resolution that the corporation be dissolved. Dissolution was not a part of the transaction, although Barnes contemplated dissolving the corporation after it rebuilt or bought other hotel property. It was the express intention and desire of Barnes that the corporation should continue, for the reason, among other things, that it would facilitate borrowing money for rebuilding. The corporation did continue in existence. It acquired the Hines property even before Jacob parted with the stock. It purchased the Hines hotel property. **$20,422.10 remained the property of the corporation in any event.** Conley, respondent's witness, testified (Tr. **p. 128):**

"At least it was left in the company."

And Barnes, respondents' witness, acknowledged that it was left in the corporation, in his letter of January 4, 1938. **(Petitioners' Exhibit 5, pages 164-166).** The corporation continued in existence until dissolved in January, 1941. **(Tr. p. 211)**

It was contemplated from the very inception for the purpose of avoiding a tax on the corporation for

the profit resulting from the receipt of the fire insurance money, that the corporation should continue to function as such and engage in the ownership and operation of hotel property either by reconstructing the destroyed building or purchasing other hotel property, and that the money should be set apart for that purpose in accordance with the statute covering involuntary conversion. (26 U.S.C.A. 112(f).) This understanding was embodied in the oral advice which Jacob gave to Barnes and Conley and was confirmed in the letter which he sent Barnes.

All of these circumstances and subsequent course of conduct are inconsistent with a liquidation of the corporation and consistent only with the conclusion that the transaction was a sale of the stock to Barnes and that the money which he turned over to Jacob was payment for that stock.

The most that can be said is that Barnes and Jacob construed differently the legal effect of the transaction. That would not justify adoption of Barnes' interpretation if in law it was a sale by Jacob to Barnes.

If the transaction was to be a liquidation of the corporation then why was it necessary to transfer any stock at all? Why was Conley's stock rewritten and new certificates issued dividing his partly to himself and partly to his wife? Why was Barnes' stock rewritten so as to divide it party to himself and partly to his wife? Why were not the Jacob shares cancelled?

They purposely refrained from liquidating the corporation. The subsequent course of procedure was in harmony and consistent with that purpose because at least $20,422.10 was retained in the corporation. The unfinished hotel property at Hines, Oregon, was purchased for that purpose. The hotel property at Arlington was purchased and operated for that purpose.

It may be that Barnes contemplated that he would ultimately dissolve the corporation and transfer the property to himself, but this was to be only after the corporation had complied in all respects with the requirements of section 112(f) of the Revenue Act. But that does not effect the transaction. **(U. S. v. Boss & Peake Auto Co.)**

The fact that Barnes used the corporate funds with which to make the purchase does not convert the transaction into a corporate liquidation and distribution of its assets. **In legal effect Barnes either borrowed or appropriated the funds of the corporation with which to acquire personally the Jacob stock. (U. S. v. Boss & Peake Auto Co.)**

In either case the corporation had a valid claim against Barnes for the money so appropriated.

This court and others have held squarely in transferee cases that the fact that one of the stockholders uses the assets of the corporation to finance the purchase of the capital stock of another stockholder **does not make the transaction a liquidation,** and that it is none the less a purchase and sale of the stock between

the individual stockholders.

It was also decided by **this court** that the fact that the party acquiring the stock contemplated a dissolution of the corporation immediately or shortly after the consummation of the transaction does not convert the transaction into a liquidation and a corporate distribution.

> **U. S. v. Boss & Peak Auto Co., 285 Fed. 410 (Or.), affirmed 290 Fed. 167 (9th Cir.).**
> **Commissioner v. Southern Bell Tel. & Tel. Co., 102 Fed. (2d) 397 (6th Cir.).**
> **Harvard v. Commissioner, 25 B.T.A. 1161.**
> **Dudley v. Commissioner, 15 B.T.A. 570.**
> **Robinson v. Commissioner, 22 B.T.A. 395.**
> **Rolnick v. Commissioner, 20 B.T.A. 989.**

The case of **U. S. v. Boss & Peake Auto Co., 285 Fed. 410 (Or.), aff'd 290 Fed. 167 (9th Cir.), decided by this court,** is, in our opinion, decisive of the case at bar. There the stock of the corporation was owned by two stockholders in equal parts. One acquired the stock of the other and the assets of the corporation were used to pay off the retiring stockholder. The question was whether the transaction was a liquidation of the corporation or a sale of the stock by Peake to Boss. Notwithstanding the fact that upon the oral testimony there was a preponderance of the evidence that the transaction was a liquidation, the District Court and this Court held that the **legal effect** of what transpired constituted a sale of stock by Peake to Boss and that Boss alone was the transferee of the assets on the theory that he appropriated the assets and converted

them into money which he used to complete the purchase. **That is exactly what Barnes did in the case at bar.**

The summary of the facts and opinions of both courts are set forth in the Appendix, page 18.

In **Harvard v. Commissioner, 25 B.T.A. 1161,** the corporation owned a light plant and an ice plant. In December, 1923, it adopted resolutions authorizing the officers to dispose of all of its property. Sometime prior to June 1, 1924, it sold the light plant and in August, 1925, it sold its ice plant. About June 1, 1924, several individual stockholders, including the petitioners, were requested to surrender their stock and they were **paid therefor with the checks of the corporation.** This **stock** was **later re-issued to W. E. Corn** who was the **dominant stockholder.** After that transfer of stock the corporation continued to function until October, 1925, when it voted to dissolve.

Respondent determined transferee liability against the stockholders. The Board reversed the determination because the corporation continued in business for more than a year after the alleged transfer. (Text of opinion, Appendix, p. 35.)

In **Commissioner v. Southern Bell Tel. & Tel. Co., 102 Fed. (2d) 397 (6th Cir.),** the stockholders, sought to be held liable as transferees, contracted with one Stearn to sell him their stock at a fixed price per share. They endorsed the certificates and placed them in a trust company in escrow to be held until the payment

of the purchase price. The corporation was dissolved and thereafter **the money with which the purchase price of stock was paid was realized from the sale of assets of the corporation.** In affirming the ruling of the Board of Tax Appeals that there was no transferee liability, the court held:

> "Under Section 602 of the Revenue Act of 1928, in a proceeding before the Board of Tax Appeals, **the burden of proof rests upon the Commissioner to show that a petitioner is liable as transferee** of a taxpayer but the transferee must carry the burden of showing the transferor was not liable for the tax.
>
> . . . .
>
> "(10) Under this principle, the respondents, not being stockholders of the Fayette Company at the time of its dissolution and the transfer of its assets to the Lexington Company, could not be held liable as transferees. **The fact that the purchasers of their stock procured the moneys out of which they were paid from the sale of the assets of the corporation does not alter the rule."**

In Rolnick v. Commissioner, 20 B.T.A. 989, Rolnick and one Glass were each owners of one-half of the capital stock of the corporation. Glass was also a creditor of the corporation for money loaned to the extent of $29,000.00. The **corporation borrowed** $35,000.00 from the bank. The $35,000.00 was paid over to Glass, $29,-000.00 to liquidate the indebtedness and $6,000.00 for the purchase price of his stock which was taken over by Rolnick. The board held Rolnick to be a transferee of corporate assets to the extent of $6,000.00 which was paid over to Glass for the stock taken over by Rolnick.

The same thing happened in the case at bar. Barnes used the corporate funds either as a loan or appropriation with which to purchase the Jacob and Conley stock.

Upon the authority of the cases referred to above we submit that the transaction which resulted in the receipt of the fund in question by Robert T. Jacob was not a liquidation of the corporation, in fact or in law. **The sum and substance of the transaction is that Barnes, desiring the continuance of the corporation and to become the owner of the stock of the corporation, purchased the Jacob and Conley stock and paid for it by utilizing corporate funds.** Whether he misappropriated the funds or whether in legal contemplation he borrowed them from the corporation, is unimportant so far as the legal effect of the transaction is concerned.

The respondent clearly failed to establish that basic fact by a preponderance of the evidence. He did not sustain the burden of proof as to the allegation that the corporation was liquidated and that the money received by Jacob was a liquidating dividend.

The fact that the amount received by Jacob approximated one-third of the net worth of the corporation is of no significance. The ownership of the stock represents an alliquot part of the corporate net worth and it is reasonable that stock should be sold for its intrinsic worth. In **U. S. v. Boss & Peake Auto Co., 295 Fed. 167,** this court said:

> "The fact that the selling price of the stock was fixed at approximately half of the value of the assets of the corporation is of little significance in view of the fact that each party owned half of the stock."

In **Sturtevant Co. v. Commissioner, 47 B.T.A., case No. 56, August 5, 1942,** the question for determination was whether the transaction was a sale of stock or a liquidation of the corporation and the Board in the opinion by Board member Sternhagen, upholding the contention of the taxpayer that the transaction was a sale said:

> "There is no more reason to act upon an artificial designation when used by the government than when used by the taxpayer."

So in the case at bar the transaction must be determined in accordance with the intention of the immediate parties involved which did not contemplate either dissolution or liquidation of the corporation. The transaction cannot be converted into a liquidation because by so doing the Government will be placed in a more favorable position with respect to tax liability.

In **Gregory v. Commissioner, 293 U.S. 465, 55 S. Ct. 266 the Supreme Court** held that in determining the character of a transaction the "motive" or "ulterior purpose" will be disregarded and the character established "by what actually occurred". The Court also said:

> "The legal right of a taxpayer to decrease the amount of what otherwise would be his taxes, or altogether to avoid them, by means which the law permits, cannot be doubted."

Upon this principle we cannot disregard in the case at bar the evident intention of all of the parties that there was to be neither a liquidation or a dissolution of the corporation, that they contemplated the continuance and operation of the corporation; **that there was to be only a change of stock ownership;** and that Barnes and his wife (who would become stockholders) would cause the corporation to reconstruct the hotel, or purchase another hotel and operate the same in the manner outlined in the advise given to the parties by Jacob, until such time as the stockholders saw fit to dissolve the corporation.

→ 56-a

POINT VI.

There is no finding of fact that respondent exhausted the available remedies against the taxpayer and there is no competent evidence in the record that would sustain such a finding. Transferee liability cannot be imposed until all remedies are exhausted to collect the tax liability out of the taxpayer's property.

SUMMARY OF ARGUMENT

Without a finding of fact that respondent exhausted his remedies against the taxpayer, transferee liability cannot be imposed. The record establishes that the taxpayer (corporation) had property more than sufficient to satisfy the tax liability at the time of the alleged transfer and at the time of the com-

a.

Corporate entity of the Central Holding Co. and its continued existence cannot be ignored.

Commissioner v. Eldridge, 79 F. 2d 629, 9th Cir.
Burnett v. Clarke, 287 U.S. 404.
Klein v. Board of Supervisors, 282 U.S. 19.
U. S. v. Phellis, 257 U.S. 156.
Eisner v. Macomber, 252 U.S. 189.
Lynch v. Hornby, 747 U.S. 339.
Jones v. Helvering, 71 F. 2d 214.
Dalton v. Bower, 287 U.S. 404.

In the **Jones case, supra,** the court said:

"The Supreme Court has been at great pains to point out time and again that a corporation is a legal entity and as such wholly different and distinct from its shareholders. In a recent case the Court said: 'But it leads nowhere to call a corporation a fiction. If it is a fiction it is a fiction created by law with intent that it should be acted on as if true. The corporation is a person and its ownership is a nonconductor that makes it impossible to attribute an interest in its property to its members.' "

In the **Dalton case, supra**, the Supreme Court said:

"Certainly under the general rule for tax purposes, a corporation is an entity distinct from its stockholders, and the circumstances here are not so unusual as to create an exception."

b.

This rule applies even where there is only one stockholder.

Burnett v. Commonwealth, 287 U.S. 415.
Christopher v. Commissioner, 13 B.T.A. 729.

c.

The fact that minimizing the tax burden was one of the reasons for continuing the corporate existence, does not warrant ignoring the corporate entity. **Commissioner v. Eldridge, supra (9th Cir.)**, and **Jones v. Helvering, supra.**

In the **Eldridge case, supra**, this Court said:

> "It is argued by the Commissioner that the transfers by respondents to the corporation were made for the purpose of establishing a deductible loss for income tax purposes. This, if true, is unimportant. A taxpayer may resort to any legal method available to him to diminish the amount of his tax liability. Gregory v. Helvering, supra; Superior Oil Co. v. Mississippi, 280 U.S. 390, 395; Bullen v. Wisconsin, 240 U.S. 625, 630; Jones v. Helvering, supra."

mencement of the transferee proceeding. The warrant of distraint was never executed; no return was ever made. The evidence fails to establish that any efforts were ever made that would have potency to obtain satisfaction of the tax liability. Respondent did not avail himself of the remedies provided by 26 U.S. C.A. 3615 and 3654 to discover assets of the corporation.

ARGUMENT

The court below made no finding of fact that respondent exhausted his remedies against the property of the taxpayer (corporation). Under the authorities referred to hereafter, Transferee liability cannot be imposed without the performance of that condition precedent. It is just as essential as a return of execution nulla bona prior to commencement of a judgment creditor's suit.

Neither does the record contain any substantial evidence on which such a finding could be made.

The record so far as it bears upon the efforts made by respondent to exhaust his remedies against the property of the taxpayer is as follows:

On November 9, 1938, a warrant of distraint (Resp. Exh. P) was made out (Tr. p. 145). It bears the notation that on March 7, 1939, liens were filed with the Clerk of the United States District Court at Portland, Oregon with the County Clerk of Multnomah County, Oregon, with the County Clerk of Harney County, Ore-

gon, and the County Clerk of Gilliam County, Oregon. The principal place of business of the corporation and its address was in Portland, Multnomah County, Oregon. The Welcome Hotel, which was destroyed by fire was located in Harney County, Oregon. The Arlington Hotel property which was purchased in December, 1937, was located in Gilliam County, Oregon.

Robert Ellison, a special zone deputy, testified that he received the warrant in **March**, 1938. (Tr. p. 145) This seems erroneous because the warrant is dated **November**, 1938, and from the fact that the liens were filed March 7, 1939, it is very likely that he meant to testify that he received the warrant in March, **1939**. The warrant requires that return be made on or before the 60th day (Tr. p. 147). The warrant contains instructions that upon execution of the warrant it should be promptly returned with a report showing in full the action taken in each case (Tr. p. 149). When it is returned with the report of "no property found liable to distraint", the deputy so reporting must accompany the return warrant with his **affidavit** on form 53 (Tr. p. 150).

He testified that he wrote a letter "to our deputy" at Pendleton asking him to call upon the taxpayer (corporation) (Tr. p. 151). He did not testify to the result of this effort.

He then testified that he personally called upon a Mr. Phipps in the American Bank Building who "is said to be counsel for the taxpayer (corporation) and asked him what the possibility of collection of the ac-

count was." (Tr. p. 152). He did not testify to the results of that conversation. There was no evidence that Phipps was the counsel for the taxpayer (corporation) and no explanation was given as to why he did not interview either Mr. Barnes or Mrs. Barnes or Mr. Conley who were then the officers of the corporation. He then testified, under question of the Board Member, that he called on a deputy in the office by the name of McEntee and asked him to call upon one of the officers of the corporation at Arlington, who, he believed, was in the Vendome Hotel there and he asked him to make an appropriate investigation of the corporation's assets for the purpose of determining whether or not the tax could be collected **and the report of that deputy was in the negative**; that the corporation was found to have an indebtedness in excess of its assets. (Tr. p. 152)

Objection was interposed to the question propounded by the Board Member but before the objection could be fully stated the Board Member said: "Just a minute. If you want to make an objection you may move to strike everything afterward."

Therefore, at the conclusion of the testimony a motion was made to strike the evidence as incompetent, irrelevant and immaterial, as **hearsay**; and on the ground that the action taken in the warrant of distraint can only be established by the **returns required by law to be endorsed thereon.** The motion to strike was denied and exception was taken. (Tr. p. 153)

It seems too plain for words that this testimony was entirely incompetent. The witness was permitted to narrate **hearsay** statements made to him by McEntee who in turn had interviewed someone at the Vendome Hotel, at Arlington, which is **not the hotel owned by the taxpayer** (corporation). He did not advise the court who was interviewed. It does not even appear that he did interview any officer of the taxpayer corporation. No showing was made as to what the investigation consisted of, what was said or what was done.

The deputy was not produced so he could be cross-examined, nor was his absence accounted for by the respondent.

The testimony is so palpably objectionable that no citation of authority is needed to demonstrate the proposition.

In any event, the action taken upon legal process can only be established by the lawful **return** of the officers who had the process for execution. **Here no return was ever made.** The blank form appearing upon the warrant (Tr. p. 148) shows that no return was made.

The instructions require that when a return of "no property" is made, that it must be **accompanied by an affidavit** on Form 53. No such affidavit was produced and there is no evidence that it was ever made.

It was obviously intended that it should not be sufficient for the executing officer to say that he found

no property. He was required to make a written statement **under oath** as to the activities which he engaged in to locate assets. From such an affidavit there would be at least prima facie evidence as to what efforts were exerted reasonably calculated to determine whether assets were available for satisfaction of the warrant.

It is well settled that action taken upon process cannot be established by parol. The written return of the officer is the only competent evidence.

> 50 C.J. 573.
> Morrison v. Covington, 100 So. 124 (Ala.).
> Sanford v. Edwards, 47 Pac. 212 (Mont.).
> King v. Bates, 45 N.W. 147 (Mich.).

The evidence of the witness Ellison that the report of that deputy (McEntee) was in the negative and that the corporation was found to have an indebtedness in excess of the assets, was clearly **hearsay**; and being parol evidence of execution of process was clearly incompetent. It therefore had no probative value as evidence of the exhaustion of remedies against the property of the taxpayer (corporation).

None of the deputies with whom the witness Ellison communicated were called to testify.

Now the failure to make a return of "no property", or any return at all, is highly significant in view of the fact that the taxpayer (corporation) actually did have property which could have been subjected to the satisfaction of its tax liability.

Why was no effort made to subject that property to the satisfaction of the tax liability?

Why was no effort made to examine Barnes under oath to discover property subject to distraint?

Why was no effort made to enforce the liens filed in the offices of the County Clerk of the three separate counties and in the Federal Court?

Why was no levy made upon the bank accounts of the corporation?

Why was no effort made to reach the $14,000.00 remaining after the purchase of the Arlington Hotel?

These questions demand an answer and explanation by respondent. The record is devoid of any answer to these questions.

This is all of the evidence as to the efforts made to ascertain assets of the taxpayer, Central Holding Company, and to satisfy the tax liability.

We submit that this did not constitute evidence of the exhaustion of respondent's remedies to satisfy the tax liability. These efforts were futile. The corporation had property standing in its name. It conducted its business at Arlington, Oregon. It presumably had its bank account there. Liens were filed and resort should have been had to that property for satisfaction of the taxpayer's liability.

The Internal Revenue Law clothes the Collector with ample power and authority to ascertain property subject to levy on the warrant of distraint. (**26 U.S.C.A., Sec. 3615 and 3654.**) These provisions give the Collector authority to examine all persons, papers, books,

accounts, and premises; to administer oaths, and to summon any person to produce books and papers, or to appear and testify under oath before him, in connection with the collection of internal revenue. There is no evidence that the respondent availed himself of the remedies provided for by law for the satisfaction of the corporation's tax liability.

The deeds conveying the Hines property and Arlington property to the Central Holding Company were duly recorded (see original Pet. Exh. 1 (4) and 2 (1 and 2). They therefore were **public notice** to the respondent. The procedure provided for by 26 U.S.C. A. 3615 and 3654, if availed of, would have disclosed the ownership of the property and the balance of the $20,422.10 fund which remained the property of the corporation (Conley, Tr. p. 128).

Had the respondent availed himself of these remedies the assets would have been ascertained and they could have been subjected to the satisfaction of the corporation's tax liability.

It is now settled beyond question that transferee liability cannot be initiated until respondent has exhausted his remedies against the property of the taxpayer.

Wire Wheel Corporation of America v. Commissioner, 16 B.T.A. 737-741, aff'd 46 F. (2d) 1013. (Text in Appendix, page 27.)
Commissioner vs. Oswego Falls Corporation, 71 F. (2d) 673. (Text in Appendix, page 29.)
Terrace Corporation v. Commissioner, 37 B.T.A. 263. (Text in Appendix, page 24.)

Gleichman v. Commissioner, 17 B.T.A. 147. (Text in Appendix, page 30.)
Troll v. Commissioner, 33 B.T.A. 598-604. (Text in Appendix, page 31.)
Florence McCall v. Commissioner, 26 B.T.A. 292. (Text in Appendix, page 33.)

The **Troll case** is especially significant. In that case a warrant of distraint was also issued but no return of the warrant was made. The Board pointed out particularly that the deputy collector who testified failed to give details as to the efforts he made to locate assets. The Board attached high significance to the absence of a return nulla bona. The Board said:

> "It is significant that he did not return any warrant of distraint nulla bona or make any return whatsoever upon the form provided thereon for the purpose or in any other form. . . . .
> . . . .
>
> **"His conduct is open to the inference that he was not in a position as a matter of fact to make such return."**

These observations are, of course, equally applicable to the case at bar.

In the case at bar, as in the case cited, a warrant of distraint was issued but no return was ever made thereon on the required form or on any form. Thus respondent's conduct "is open to the inference that he was not in a position as a matter of fact to make such return".

In the case cited, because of the failure to make the return, the Board held that the corporation "may have had other assets on March 1, 1930 of a value sufficient

to cover all of his liabilities." In the case at bar we have not only the inference resulting from the failure to make the return, but **we have affirmative evidence ot the existence of assets out of which satisfaction of the tax liability could be made.**

POINT VII.

There is no substantial evidence to sustain a finding that Central Holding Co. was insolvent or rendered insolvent at the time of (a) the alleged transfer, or (b) at the time the transferee proceedings were commenced.

SUMMARY OF ARGUMENT

The evidence establishes that the corporation had assets more than sufficient to pay its tax liability **at the time of the alleged transfer.** The evidence establishes that the corporation had assets more than sufficient to pay its tax liability **at the time the transferee proceedings were initiated.** While the return of a warrant of distraint makes a prima facie showing of insolvency, the rule does not apply in this case because no return whatsoever was made of the warrant of distraint.

ARGUMENT

The burden of proof is upon respondent to establish insolvency of the taxpayer (Central Holding Co.) (a) at the time of the alleged transfer, and (b) at the

time of the commencement of the transferee proceeding.

In **Terrace Corporation v. Commissioner, 37 B.T.A. 263**, the transfer of assets was made July, 1933, a warrant of distraint was issued, and returned nulla bona in March, 1934—some nine months later. The transferee liability was asserted at that time and the Board held:

> "It should be kept in mind that in a transferee proceeding **insolvency** must be proved **at two basic dates: (1) at the time of the transfer of the property; (2) at the time the creditor brings his action to subject the property in the hands of the transferee to the payment of his claim.** The first is necessary in order to show that the conveyance was a fraud on the transferor's creditors. The second is necessary in order to show that the primary debtor is unable to respond to the creditor's demand and therefore a resort to a secondary liability is justified."

It was also held in that case that the respondent had the **burden of proof** to establish insolvency and until he does so "there is no obligation upon the transferee to go forward with his defense". The fact that a warrant of distraint was returned nulla bona some nine months after the transfer, does not establish that the taxpayer was insolvent at the time of the transfer.

(See text of opinion, Appendix page 24)

In **Lehigh Valley Trust Co., Executor v. Commissioner, 34 B.T.A. 528, 534**, the Board, quoting from an earlier decision held that the respondent "must prove

that the distribution of assets rendered the transferor corporation insolvent (citing cases)" and that "if the respondent does not sustain the burden of proof . . . . he fails."

In **Troll v. Commissioner, 33 B.T.A. 598,** the Board held that before transferee proceedings may be brought against a transferee it must appear that the remedies against the transferor "would be of no avail" and that the failure to prove insolvency necessitates a determination in favor of the petitioner. **In that case there was evidence that the taxpayer "had no funds", but the Board held that that was not sufficient to establish insolvency because it appeared that he had other assets and the evidence did not adequately demonstrate that they were of no value.** The same is true in the case at bar.

In **Wray v. Commissioner, 24 B.T.A. 94,** the corporation was dissolved in October, 1932 and paid a liquidating dividend but there was evidence that some assets had not been distributed. The transferee liability was assessed in 1935. The Board held:

> "The provisions of **section 280** constitute an extraordinary method of collecting the taxes of the person who is primarily liable therefor, and consequently they **must be construed strictly against the respondent.**"
>
> . . . .
>
> "The mere fact that a corporation is dissolved and that its assets were distributed are not of themselves sufficient to hold the distributee.
>
> . . . .

> ". . . The assessments were made in 1925. The record does not show that at that time the corporation or its representatives were unable to pay its alleged tax obligation or that respondent exhausted his resources in an attempt to collect from the corporation."

In this case the respondent does not have the benefit of the prima facie showing which results from the return of an execution nulla bona because the warrant of distraint bears no return.

The alleged transfer was made August 17, 1937. The taxpayer's fiscal tax year began July 1, 1937 and ended June 30, 1938. The return and payment of the income tax was due September 15, 1938.

The record discloses that all of the obligations of the corporation (except income tax liability to accrue at the end of that current fiscal year) were paid off out of the first insurance money received (Tr. p. 128). After the first insurance money was received ($18,000.00) and before Jacob received any money, the corporation transferred $5,000.00 to Burns, Oregon, where a bank account was opened in the name of the corporation. With a portion of this money ($2809.27) it purchased from Harney County an unfinished hotel property at Hines, Oregon, which the county had formerly acquired by tax foreclosure (see deed No. 2, Petitioners' Exhibit 1, Tr. p. 138). Title was originally taken in the name of E. W. Barnes. On the same day, Barnes conveyed the property to his wife (Deed No. 3, Exhibit 1) and thereafter Barnes and his wife conveyed that property together with other property

to the Central Holding Co. (see Deed No. 4).

The only evidence of value of the Hines property was that $2,809.27 was paid to Harney County and it was later conveyed for a consideration of $15,000.00 in the purchase of the Arlington Hotel property. No testimony was introduced as to the **actual market value.**

Assuming, without conceding, that the $20,422.10 received by Jacob and a similar amount received by Conley were corporation funds, **there still remained in the corporation the additional sum of $20,422.10.** Conley testified: (Conley, Tr. p. 128 and Pet. Exh. 5, Tr. pp. 164-166.)

Barnes, who together with his wife were the only stockholders, obviously did not distribute the remain- $20,422.10 to himself and certainly **no part of it to his wife** who was also a stockholder, but allowed it to remain the property of the corporation as he said in his letter.

This was obviously done to comply with the advice he received from Jacob that the corporation was to continue to function in the manner contemplated by the statute governing involuntary conversions. (26 U.S.C.A. 112(f)).

It appears, therefore, that at the time of the transfer the corporation owned the Hines property purchased for $2800 from the County and later transferred for a consideration of $15,000.00; and it had $20,422.10 in cash. It had no liabilities except the income

tax liability that would accrue at the end of the fiscal year. This was the situation at the time of the alleged transfer.

In November of the same year the corporation contracted to purchase the hotel at Arlington, Gilliam County, Oregon. The transaction was consummated December 15, 1937 (Petitioners' Exhibit 2, Tr. p. 139). At that time the Arlington Hotel property was deeded to Central Holding Co. The purchase price was $50,000.00 which was paid as follows: $6313.08 in cash, $15,000.00 by conveyance of the Hines Hotel property, $5,000.00 by assuming taxes and $23,868.00 by execution of a purchase money mortgage. (Tr. p. 138) There was a slight variance in the cash (not material) by reason of the tax adjustment. The title to the property remained in the Central Holding Co. until September, 1938, when it was conveyed to Barnes without consideration (Tr. p. 138). The corporation was dissolved January 6, 1941 (Tr. p. 211).

Barnes testified that after the purchase of the Arlington Hotel, $4,000.00 was used in making repairs (Tr. p. 158); that the cash paid to Amato on account of the purchase price and the $4,000.00 he spent on repairs was paid out of the aforesaid $20,400 (Tr. p. 163).

The result was that in December, 1937, after the Arlington Hotel property was purchased by the taxpayer corporation, it owned the Arlington Hotel, purchased at $50,000.00 with obligations against it (purchase money mortgage and taxes) of $28,868.00 or an

equity in excess of $21,000.00, to which should be added $4,000.00 which was spent in repairs and improvements, making the equity worth in excess of $25,000.00.

The corporation also had left the difference between the $20,422.10 (left in the corporation) and the cash expended on account of the purchase and repairs of the Arlington Hotel property (approximately $10,000.00), which left on hand in excess of $14,000.00 in cash. Altogether, in December, 1937, the corporation had assets consisting of $25,000.00 equity in the hotel at Arlington, and in excess of $14,000.00 in cash, a total in excess of $39,000.00. There is no evidence of any other liability except the tax liability which is here involved.

We submit that upon this record there is a total failure of proof that the taxpayer was insolvent at the time of the alleged transfer of the funds to Jacob and at the time of the commencement of the proceedings to impose transferee liability upon petitioners which was initiated by the notice dated April 8, 1941 (Tr. p. 19).

Since the burden of proof of insolvency was on the respondent, and since the record discloses that the Hines property belonged to the corporation, the burden was upon respondent to establish the true market value of the Hines property.

It has been held that the purchase price paid for property is some evidence of value. That, of course, is true only in a purchase and sale at arm's length in the ordinary course of business. It does not apply to

liquidation sales, tax sales and the like. All the record discloses in this case is that it was acquired for $2800.00 and sold for $15,000.00. With the record in this condition and the burden of proof being upon the respondent it cannot be said that the property had no value or that its value was not $15,000.00. We submit that the burden was upon the respondent to establish by competent evidence **the true market value** of the Hines property and that it was not worth $15,000.00, the amount at which it was accepted by the Amato's.

CONCLUSION

The opinon of the Court below bears every indication that it lost sight of the true issue in the case. It overlooked the fact that the proceeding is in rem; that a particular res is to be recovered and that only the one who obtained the res is liable for it. Instead it proceeded on the theory that a personal liability could be imposed on petitioners if they had acquired an equitable interest in the res and a coincident right to recover it from Jacob, who obtained it "upon a claim of right" as his own.

It is immaterial whether Jacob's claim of ownership is well founded in law or not. **The fact remains that he alone has possession of the res being followed.** And it is immaterial whether petitioners are in law or in equity entitled to recover the res from Jacob. The fact remains that they did not obtain possession of the res being followed. Until they assert and enforce their

right to possession (if they have any) they are not transferees and could not be held liable in a judgment creditor's suit.

Petitioners cannot be charged with possession merely because they might have a right (questionable) to possession as against one who has the actual possession and retains it "under a claim of right."

Throughout the opinion the emphasis is placed on Jacob's **intention** to give the stock to petitioners. There never was any issue in this respect. Jacob so asserted in the memorandum attached to his personal income tax return, in his petition to review the transferee liability assessed against him and in his testimony in this case. **The fact remains that he did not carry out but abandoned his intentions when the conditions changed.** As a matter of law he had the right to do so and accordingly received and retained the proceeds from the sale of the stock as his own.

We submit that his abortive intention cannot and does not place petitioners in possession of the res.

To impose liability on petitioners under the facts in this case is to penalize them because Jacob changed his mind about giving them the stock.

It is also evident that the court below misconstrued the true import of the transferee statute, for it said:

> "The liability having attached under the statute any subsequent appropriation by Jacob to his own use of the funds so received by him for petitioners cannot affect their liability herein."

It has been repeatedly stated by the courts, including the Supreme Court, that the statute did not create any liability and that it only afforded an additional summary remedy to enforce the liability at law or in equity where one already existed. This was not a case where petitioners first came into possession of the res and thereby became liable as transferees, and later it was appropriated by Jacob. Here the liability never attached to petitioners because they never received the res.

The transferee liability, if any, attached to Jacob at the very moment he received the res as his **own**, not by virtue of the statute but because it was in legal contemplation a "trust fund". There was no subsequent change of possession which would transfer to or impose the liability on petitioners.

It has also been demonstrated that the fund in question was not a liquidating dividend; that the corporation was not liquidated or dissolved but continued thereafter as a going concern. Hence the fund cannot in law or in equity be regarded as a trust fund.

It has also been demonstrated that the corporation (taxpayer) was solvent at the time of the alleged transfer and at the time the transferee proceedings were initiated; that at both these times it owned assets more than sufficient to take care of the $6,000.00 tax liability; and that the respondent utterly failed not only to exhaust the available remedies against the taxpayer which would have resulted in satisfaction of the

tax liability but to make any reasonable effort in that direction, which had any potency to subject taxpayer's assets to the satisfaction of this obligation.

As to the exhaustion of remedies there is no finding of fact whatsoever and this alone is fatal to the judgment of the court below.

The Court below also lost sight of the fact that in this case the burden of proof upon every material fact was upon respondent. This is manifest because the Court below in a number of instances drew an inference adverse to petitioners from the alleged absence of evidence on a given fact. That would be true only if petitioners had the burden of proof, but since the respondent had the burden of proof, the Court below should have drawn an inference adverse to respondent.

In 22 C.J. 112 the text is as follows:

> "**Force of presumption.** The unfavorable presumption or inference arising from the withholding of evidence is not, of course, conclusive against the party, but is merely a fact for the consideration of the jury; and **such failure cannot be relied upon by the other party as affirmative proof of the facts as to which the burden of proof is upon him,** although it may turn the scale where the evidence is closely balanced."

The Court below committed error in its failure to appraise the evidence and the absence of evidence in accordance with the legal standards.

Under these circumstances the decision of the court below should be reversed.

S. J. BISCHOFF,
Attorney for Petitioners.

APPENDIX

APPENDIX

In **Higley v. Commissioner, 69 Fed. (2d) 160 (8th Cir.)**, the court held:

> "If a trust beneficiary is to be personally liable under this section, it must be because he is a 'transferee'. In a broad sense, **and irrespective of this section,** such a beneficiary might be regarded as a "transferee" under a trust instrument. In the same sense, a **trustee,** who takes the entire legal title, is **certainly** a **'transferee'** under such an instrument. In short, one (the trustee) would **always** be regarded as a transferee and the other (the beneficiary) **might be** so regarded. The question here is the meaning intended in this section. The section expressly covers transfers **other than** trusts. The employment of the word 'transferee' must apply to such other transfers, and the presence of the word is readily explainable in that connection. But, in addition, the word 'trustee' is employed in connection with trusts only. The result is that the **application** of 'transferee' **to trust beneficiaries** is **at least doubtful** and the **statute** in that **respect ambiguous.** In such a situation the beneficiary is entitled to a favorable construction because liability for taxation must clearly appear. Miller v. Standard Nut Margarine Co., 284 U.S. 498, 508, 52 S. Ct. 260, 76 L. Ed. 422; U. S. v. Updike, 281 U.S. 489, 498, 50 S. Ct. 367, 74 L. Ed. 984; U. S. v. Merriam, 263 U.S. 179, 187, 188, 44 S. Ct. 69, 68 L. Ed. 240, 29 A.L.R. 1547.
>
> "Passing from consideration of this section **alone** to consideration of it **as a part of the general scheme of collecting this estate tax,** the position of petitioner is further strengthened. Throughout this chapter (estate taxes) runs the clear plan as to collection. The prime reliance is the **property** subject to the tax. Upon this a lien

for the taxes is placed. As further assurance, a personal liability is placed upon those who are in position to dispose of the property and possibly delay or defeat collection. Upon them is placed a strong personal incentive to see that the tax is properly and promptly paid. **This burden is placed only upon those** (executors, administrators, fiduciaries, transferees, trustees, and insurance beneficiaries) **who have such legal title, control, and possession as would afford opportunity to dispose of the property primarily liable for the payment of the tax.** A trust beneficiary may or may not occupy such a position, dependent upon the terms of the trust, but all opportunity for him to take advantage thereof is anticipated and guarded against by placing upon the trustee a personal liability and by attaching the lien to the trust property. Although Congress has legislated repeatedly in this matter, it has in no instance used language clearly providing personal liability of a cestui que trust."

In **Section 75 of the Restatement of the Law of Trusts**, the rule is stated as follows:

"AN INTEREST WHICH HAS NOT COME INTO EXISTENCE OR WHICH HAS CEASED TO EXIST CANNOT BE HELD IN TRUST."

"COMMENTS: . . . . .

Thus if a person **gratuitously declares himself trustee** of such shares as he may thereafter acquire in a corporation not yet organized, **no trust is created**. The result is the same where instead of declaring himself trustee, he purports to transfer to another as trustee such shares as he may thereafter acquire in a corporation not yet organized. In such a case **there is at most a gratuitous undertaking to create a trust in the future**, and such an undertaking is not binding as a contract, for lack of consideration . . . .

C. WHERE SETTLOR SUBSEQUENTLY ACQUIRES AN INTEREST. If a person purports to declare himself trustee of an interest not in existence or if he purports to transfer such an interest to another in trust, no trust arises even when the interest comes into existence in the absence of a manifestation of intention at that time (see § 26)."

In **Brainard v. Commissioner, 91 Fed. (2d) 880 (7th Cir.)**, the petitioner

". . . . declared a trust of his stock trading during 1928. . . . to distribute the profits, if any, in equal shares to his wife, mother and two minor children after deducting reasonable compensation for services . . at the end of the year determined his compensation . . . which he reported in his income tax return for that year. The profits remaining were then divided into approximately equal shares among the members of his family, and the amounts were **reported in their respective tax returns for 1928.** The amounts allocated to the beneficiaries were credited to them on taxpayer's books, but they did not receive the cash, except taxpayer's mother, to a small extent."

The Circuit Court of Appeals held:

"It is obvious, therefore, that the taxpayer based his **declaration of trust** upon an interest which at that time had not come into existence and in which no one had a present interest. In the Restatement of the Law of Trusts, Vol. 1, section 75, it is said that **an interest which has not come into existence or which has ceased to exist cannot be held in trust.** It is there further said: "A person can, it is true, make a contract binding himself to create a trust of an interest if he should thereafter acquire it; but such an agreement is not binding as a contract unless the requirements of the law of Contracts are complied with . . . .

"Thus, if a person gratuitously declares himself trustee of such shares as he may thereafter acquire in a corporation not yet organized, no trust is created. The result is the same where instead of declaring himself trustee, he purports to transfer to another as trustee such shares as he may thereafter acquire in a corporation not yet organized. **In such a case there is at most a gratuitous undertaking to create a trust in the future, and such an undertaking is not binding as a contract for the lack of consideration.**

". . . . **If a person purports to declare himself a trustee of an interest not in existence, or if he purports to transfer such an interest to another in trust, he is liable as upon a contract to create a trust if,** but only if, the requirements of the law of Contracts are complied with. See also Restatement, section 30b; Bogard, Trusts and Trustees, Vol. 1, section 112. In 42 Harvard Law Review 561, it is said: 'With logical consistency, the courts have uniformly held that an **expectancy cannot be the subject matter of a trust and that an attempted creation, being merely a promise to transfer property in the future, is invalid unless supported by consideration.'** (Citing Lehigh Valley R. R. v. Woodring, 116 Pa. 513.) Hence, it is obvious under the facts here presented that taxpayer's declaration amounted to nothing more than a **promise to create a trust in the future,** and its binding force must be determined by the requirements of the law of Contracts.

. . . .

"From what has been said we are convinced that appellant's profits in question were **not impressed with a trust when they first came into existence."**

In **Weil v. Commissioner, 31 B.T.A. 899, Affirmed, 82 Fed. (2d) 561 (5th Cir.), certiorari denied, 299 U.S. 552,** the taxpayer was the owner of a block of stock of the Coca Cola Company. On October 1, 1930, he took

out eight certificates representing 800 shares of said stock and he placed certificates representing 200 shares in envelopes bearing the name of each of his four minor children. He had kept these envelopes bearing the names of his children for sometime prior to this transaction. In these envelopes there were other securities belonging to the children. He made a memorandum of the certificate numbers that he placed in each of the envelopes and when he returned to his office he made or caused to be made entries in a memorandum book in which were recorded the securities owned by the children. On October 1, 1930, he withdrew from his own stockholdings certificates representing 400 additional shares and placed certificates representing 100 shares in each of the envelopes belonging to the children and again appropriate entries were made in the aforementioned memorandum book. Later petitioner gave instructions to sell for his children 200 shares each of the said stock with directions that the proceeds should be placed to the credit of the children on the books of the firm of which he was a member. The stock was sold on the market and a **sales slip showed that the sales were for the account of the children**. Appropriate credits were given to the children's accounts in accordance with the direction. He did not recall whether he had endorsed the certificates but was of the impression that he did. Later he gave instructions to sell 100 shares each of the children's stock and the same procedure was followed. The accounts of the children on the books of the firm had been carried for some time prior to this transaction involving other moneys

belonging to the children as to which there was no dispute. These moneys were advanced to the firm and interest was paid to the children. They were carried on the books of the firm as loans from the children to the partnership. Petitioner had been making gifts to his children since their birth. One of the children became of age and the money was turned over to her but was thereafter managed by her father under a power of attorney, but she had a right to do with it as she pleased. He never used any of the stock or proceeds from the sale of stock for his own purpose as collateral or otherwise. The certificates had not been transferred on the books of the Coa Cola Company because he expected to sell them and wished to avoid the expense of the transfer. Petitioner was not appointed guardian of the estate of the children. A part of the proceeds of sale was later reinvested in bonds and stock, the stock being issued in the children's names. **Upon these facts** the **Commissioner contended** that the **gift of the stock had never been consummated,** that at the time of the sale of the stock it was the property of the petitioner (father) and that the profit derived from the sale of the stock was taxable as his income and not as income of the children. The petitioner contended that the gift of the stock had been completed and that the sale was for the account of the children.

The **Board and Circuit Court of Appeals,** holding that the stock was the property of the father and that the profit from the sale of the stock was taxable as his, said:

"From an examination of the authorities we find the essential elements of a bona fide gift inter vivos to be (1) a donor competent to make the gift; (2) a donee capable of taking the gift; (3) a clear and unmistakable intention on the part of the donor to absolutely and irrevocably divest himself of the title, dominion, and control of the subject matter of the gift, in praesenti; (4) the irrevocable transfer of the present legal title and of the dominion and control of the entire gift to the donee, so that the donor can exercise no further act of dominion or control over it; (5) a delivery by the donor to the donee of the subject of the gift or of the most effectual means of commanding the dominion of it; (6) acceptance of the gift by the donee; Edson v. Lucas, 40 Fed. (2d) 398, and authorities there cited. Cf. Allen-West Commission Co. v. Crumbles (C.C.A., 8th Cir.), 129 Fed. 287; Edwin J. Marshall, 19 B.T.A. 1260; affd. (C.C.A., 6th Cir.) 57 Fed. (2d) 663, certiorari denied, 282 U.S. 61.

. . . .

"The important question here is not whether there was a gift by petitioner to his children, but whether there was a **gift of the Coca-Cola stock** to them. Was there a clear and unmistakable intention on the part of the donor to give the Coca-Cola stock to his children; to absolutely and irrevocably part with the title, dominion, and control of it at the very time the gift was made, or did he intend all the while to sell the stock and give the proceeds thereof to his children?

. . . .

"Under all the circumstances we conclude that what petitioner intended to give his children and **what he gave them was not the stock itself, but the proceeds from the sale of the stock**. It follows from this conclusion that the determination of the respondent must be approved."

On appeal the Circuit Court of Appeals held (82 **Fed. (2d) 561)**:

> "We think the controlling fact is that Weil purposed all the time to sell the stock and kept control of it to do so. He was not the guardian of the children, and it is conceded that under the law of Alabama he could not sell the property of his minor children. It is plain that he intended to give his children the benefit of the stock, and perhaps went to great pains to make it appear that he had done so before the profit was realized which would be taxed in solido if his, but in separate parts and less severely if his children's; but all the time he intended to and did maintain dominion and control over the stock so as to sell it. Prior to the several sales the certificates sold never passed out of his custody into the control of any other person, they were never endorsed to the children or put in their names, nor was any writing signed and delivered by him purporting to convey them. This retention of control for the purpose of exercising dominion over them by sale is inconsistent with a present absolute gift, the legal result of which would have been to prevent a sale.
>
> . . . .
>
> "We do not doubt that a certificate of stock may without formal transfer be by such a delivery given; and if to a minor such parting of control and dominion to a third person for the child is sufficient. Whether a father may deal wholly with himself for his child without writing, without cooperation of any third person who represents the child, without doing what is ordinarily done to transfer this kind of property, and without parting with control over the certificate, we greatly doubt. Generally a donor must go as far as the nature of the property and the circumstances reasonably permit in parting with dominion and making the gift irrevocable. See Allen-West Commission Co. v. Crumbles, 129 Fed. 287; Conlon v. Tur-

ley, 10 Fed. (2d) 890; Lee v. Lee, 5 Fed. (2d) 767; Union Trust Co. v. United States, 54 Fed. (2d) 152; Moore v. Tiller, 61 Fed. (2d) 478; Jackson v. Commissioner, 64 Fed. (2d) 359. If the donor intends to give, and even goes so far as to transfer stock on the books of the company but intends first to do something else and retains control of the transferred stock for that purpose, there is no completed gift. Southern Industrial Institute v. Marsh, 15 Fed. (2d) 347. Weil's intention to sell the stock, an intention that could not be carried out if the title to it were vested in his minor children, accompanied with the retention of full control over it, suspended the execution of the intention to make a gift until after the sale, and the intended gift took final effect only upon the proceeds. The case of Smith v. Commissioner, 59 Fed. (2d) 533, is not to the contrary. The law was there asserted to be as we have stated it. Title to the stock certificates there was held to have passed from the donor to the donees not when he declared to them the gift and wrote upon the folder which was to receive the certificate and made entries on his books, but only when after endorsement of the certificates he placed them in the lock-box at the bank of one of the donees. That the donor had a key to his son's lock-box was held not necessarily to defeat the delivery, since the son knew of it and also had a key.

"The dissenting opinion of members of the Board suggests that Weil made himself trustee for his children with power to sell the stock. The cases cited for that idea dealt with formal written declarations of trusts. There was here no valuable consideration and no basis for equity to construct a trust. If there was a trust, it must have been an express trust. The evidence to establish a voluntary express trust in personal property must show a clear intention to create a trust. Equity will not make one where none has been clearly declared. **A defective or imperfect gift will not be**

converted into a trust. Elliott v. Gordon, 70 Fed. (2d) 9; Eschen v. Steers, 10 Fed. (2d) 740. No evidence has been brought to this court, and certainly no trust was found as a fact by the Board. Weil, who best knows what he did, has never claimed one. In his petition for redetermination by the Board he asserts that on Oct. 1st, 1930, and Nov. 1st, 1930, he made 'gifts inter vivos to each of his said minor children,' and 'that the gifts inter ivivos of the common stock of Coca-Cola Company which were made by him to his four minor children were bona fide, and that the subject matter of the said gifts thereupon became the absolute property of his four minor children.' Even after the suggestion of the minority opinion, Weil in his petition for review in this court alleges that there were absolute gifts to his minor children, and his assignment of error is that the Board erred in not finding that he 'made completed and absolute gifts of the stock in question to his four minor children.' His brief makes no claim that a trust was attempted."

In **Tait, Collector, vs. Western Maryland Ry. Co., 289 U.S. 620—53 Sup. Ct. 706,** the court held:

"The scope of the estoppel of a judgment depends upon whether the question arises in a subsequent action between the same parties upon the same claim or demand or upon a different claim or demand. In the former case a judgment upon the merits is an absolute bar to the subsequent action. In the latter the inquiry is whether the **point or question to be determined in the later action is the same as that litigated and determined in the original action.** Cromwell v. County of Sac, 94 U.S. 351, 352, 353, 24 L. Ed. 195; Southern Pacific R. Co. v. United States, 168 U.S. 1, 48, 18 S. Ct. 18, 42 L. Ed. 355; United States v. Moser, 266 U.S. 236, 241, 45 S. Ct. 66, 69 L. Ed. 262. Since the claim in the first suit concerned taxes for 1918

and 1919 and the demands in the present actions embraced taxes for 1920-1925, the case at bar falls within the second class. The courts below held the lawfulness of the respondent's deduction of amortized discount on the bonds of the predecessor companies was adjudicated in the earlier suit. The petitioner (collector) admitting the question was in issue and decided in respect of the bonds issued by the second company, and denying, for reasons presently to be stated, that this is true as to the bonds of the first company, contends that as to both the decision of the Court of Appeals is erroneous, for the reason that the thing adjudged in a suit for one year's tax cannot affect the rights of the parties in an action for taxes of another year.

"As petitioner says, the scheme of the revenue acts is an imposition of tax for **annual periods, and the exaction for one year is distinct from that for any other. But it does not follow that Congress in adopting this system meant to deprive the government and the taxpayer of relief from redundant litigation of the identical question of the statute's application to the taxpayer's status.**

"This court has repeatedly applied the doctrine of res judicata in actions concerning state taxes, holding the parties concluded in a suit **for one year's tax** as to the right or question adjudicated by a former judgment respecting the tax of an earlier year. (Cases.) . . . . The **public policy** upon which the rule is founded has been said to apply with **equal force to the sovereign's demand** and the claims of private citizens."

. . . .

"Is the **question or right** here in issue the same as that adjudicated in the former action? The pertinent language of the revenue acts is identical; the regulations issued by the Treasury remained unchanged; and of course the facts with respect to the sale of the bonds and the successive owner-

ship of the railroad property were the same at the time of both trials. The **petitioner suggests, however,** that **significant** facts **were stipulated in the present case which were not made to appear in the former** proceeding. He shows that in the earlier case the Commissioner inadvertently stipulated that the first company 'may be taken as identical' with the second, whereas in the present suit the exact devolution of title from the first to the second through the foreclosure and reorgaization is definitely exhibited by the stipulation of the parties. From this he concludes that the Circuit Court of Appeals might well have reached a different result on the merits, if the former case had been more fully and accurately presented. But the Circuit Court of Appeals has found that all the facts stipulated in the present cause were before it in the former one, and we accept this finding. It holds also that the former decision was based on a view of the law quite as pertinent to the bonds sold by the first company as to those marketed by the second. The petitioner may not escape the effect of the earlier judgment as an estoppel by showing an inadvertent or erroneous concession as to the materiality, bearing or significance of the facts, provided, as in the case here, the facts and the questions presented on those facts were before the court when it rendered its judgment. Compare Deposit Bank v. Frankfort, 191 U.S. 499, 510, 511, 24 S. Ct. 154, 48 L. Ed. 276. The very right now contested arising out of the same facts appearing in this record, was adjudged in the prior proceeding.

"As we have seen, the demand for refund of 1918-1919 taxes was against the Commisisoner of Internal Revenue. The present suits are against the United States and the collector. Are the parties the same **or in such privity** that the claimed estoppel binds them? The petitioner concedes that the former judgment is, so far as identity of parties is concerned, conclusive in the suits in which

> the United States is now the defendant, since the Commissioner acted in the earlier suit in his official capacity and as representative of the government. This leaves for consideration the question whether the Commissioner and the collector are for purposes of application of the rule of estoppel, to be regarded as different parties.
>
> "In a suit for unlawful exaction the liability of a collector is not official but personal. (Cases.) And for this reason a judgment in a suit to which he was a party does not conclude the Commissioner or the United States. Bankers Pocahontas Coal Co. v. Burnet, 287 U.S. 308, 311, 53 S. Ct. 150, 77 L. Ed. 325. We think, however that where a question has been adjudged as between a taxpayer and the government or its official agent, the Commissioner, the collector, being an official inferior in authority and acting under them, is in such privity with them that he is estopped by the judgment. See Second National Bank of Saginaw v. Woodworth (D.C.) 54 F. (2d) 672; Bertelson v. White (D.C.) 58 F. (2d) 792."

Summarizing that decision the Supreme Court held that the doctrine of **estoppel is applicable** where the **causes of action** are **not the same,** if a particular **issue** was determined that was **common to both proceedings** or if the issue established the **status of the taxpayer,** and it also determined that estoppel is available not only where the parties are the same in both proceedings, but are also available for and against the parties in **privity with them.**

In the case at bar the issue as to the ownership of the stock, and hence the ownership of the fund alleged to be the liquidating dividend, is common to both proceedings. It is upon the determination of that issue that

the status of transferee must be determined and since respondent proceeds on the theory that petitioners are assignees or donees of Robert T. Jacob they must be deemed in privity with him.

In **U. S. v. Moser, 266 U.S. 236, 45 S. Ct. Rep. 66,** the Supreme Court held:

> "The general principles are well settled, and need not be discussed. The scope of their application depends upon whether the question arises in a subsequent action between the same parties upon the same claim or demand or upon a different claim or demand. In the former case a judgment upon the merits constitutes an absolute bar to the subsequent action. In the latter case the inquiry is whether the **point** or **question** presented for determination in the subsequent action is the same as that litigated and determined in the original action. Cromwell v. County of Sac, 94 U.S. 351, 352, 353, 24 L. Ed. 195. The rule is succinctly stated in Southern Pacific R. R. Co. v. United States, 165 U.S. 1, 48, 18 S. Ct. 18, 27 (42 L. Ed. 355):
>
> "The general principal announced in numerous cases is that a **right, question or fact distinctly put in issue and directly determined by a court of competent jurisdiction,** as a ground of recovery, cannot be disputed in a subsequent suit between the same parties or their privies; and **even** if the second suit is **for a different cause of action,** the right, question or fact once so determined must, as between the **same parties or their privies,** be taken as conclusively established, so long as the judgment in the first suit remains unmodified."
>
> "And in New Orleans v. Citizens' Bank, 167 U.S. 371, 396, 17 S. Ct. 905, 913 (42 L. Ed. 202) this court, speaking through Mr. Justice White, said:
>
> 'The estoppel resulting from the thing adjudged does not depend upon whether there is the

same demand in both cases, but exists, even although there be different demands, **when the question upon which the recovery of the second demand depends, has under identical circumstances and conditions been previously concluded by a judgment between the parties or their privies.'**

"And see Myers v. International Co., 263 U.S. 64, 44 S. Ct. 86, 68 L. Ed. 165.

"The suits here are upon different demands and the point at issue is to be determined by applying the second branch of the rule. The question expressly and definitely presented in this suit is the same as that definitely and actually litigated and adjudged in favor of the claimant in the three preceding suits, viz. whether he occupied the **status** of an officer who had served during the Civil War.

. . . .

"A determination in respect of the status of an individual upon which his right to recover depends is as conclusive as a decision upon any other matter. Clemens v. Clemens, 37 N.Y. 69, 72; Pittsford v. Chittenden, supra.

"Affirmed."

In **U. S. v. Brown, 86 Fed. (2d) 798 (6th Cir.)**, the corporation was dissolved and the cash distributed to the three stockholders as liquidating dividends without making deduction for corporate tax liability. The government brought suit to charge the stockholders with transferee liability. While the suit was pending the Commissioner assessed the stockholders with a tax on the profit derived from the liquidating dividends (difference between the cost of the stock and the amount received). Each of the stockholders filed a petition with the Board, claiming, among other things, that in determining profit there should be deducted a

proportionate share of the amount of the transferee liability asserted against them. The Commissioner contended that the entire amount received less cost of the stock was profit and that no deduction should be made for the unpaid tax. The Board sustained the contention of the Commissioner. No appeal was taken and the decision became final. The stockholders set up this election and determination as a bar to the suit to charge them as transferees. The District Court ruled that the Commissioner was estopped by the election and the Circuit Court of Appeals, in affirming the decision, held that the Commissioner "cannot now pursue the inconsistent remedy" of transferee proceeding; that the former proceeding **"unequivocally constituted an election"** because the fund could not be income to the petitioner and at the same time be a "trust fund" subject to transferee liability and that respondent could not pursue both courses. The Court held:

> "The District Court held that the Government was estopped by the decision of the Board of Tax Appeals, and that by pressing that litigation to judgment the Government had elected not to attempt to enforce the transferee liability against the taxpayers, and therefore could not recover.
>
> "While it has been held in the Court of Claims (Warner Co. v. United States, 15 Fed. Supp. 160) that estoppel by judgment may arise out of a decision by the Board of Tax Appeals from which no apeal has been taken, it is not necessary to consider that question, as the **Commissioner made** a **binding election** in the proceedings **before** the **Board** and **can not now pursue** the **inconsistent** remedy of the equity action.

"The Government contends that as the doctrine of election is based upon a freedom of choice between inconsistent remedies (Wm. W. Bierce, Ltd., v. Hutchins, 205 U.S. 340), it is inapplicable here. It urges that the Commissioner had no choice between charging the unpaid taxes as a liability to be enforced by transferee proceedings and also assessing as personal income the entire liquidating dividends without making any deduction for **transferee liability.**

"This argument ignores the fact that the Commissioner in 1926 filed this **bill** in equity **on** the **theory** that the **taxpayers as transferees held** an **amount** equivalent to the unpaid corporation taxes **in trust** for the Government. Answers were filed and issue was joined before proceedings in the Board of Tax Appeals were instituted. The decision of the Board was rendered November 22, 1932. If the instant suit had been prosecuted and the Commissioner had obtained a judgment, the corporation taxes would have been paid long before the decision of the Board, and the amount assessed in those proceedings would have required reduction by the amount of the recoverable corporation taxes. The Commissioner exercised a freedom of choice. He chose to press the tax appeal proceedings, and this **unequivocally constituted an election.** Cf. Robb v. Vos, 115 U.S. 13, 43. So far as the corporation taxes were concerned, the Government could avail itself of one of two remedies. The **money could not constitute income** to the taxpayers and also a fund charged with a trust in favor of the Government. The **Governmen could bring the transferee action** on the **theory** of **trust, or** in the **alternative,** it **could claim** that **all** of the liquidating **dividends** constituted personal **income** to the taxpayers. **It could not pursue both courses. It deliberately chose** that the instant case should slumber in the files, and pressed the personal assessment on the theory that the entire amount of liquidating dividends consti-

tuted income. The Government is bound by its election. United States v. Oregon Lumber Co., 260 U.S. 290, 301. The Commissioner concedes that there is a 'certain equity' in the position of the taxpayers, and the court rightly so considered.

"The decree is affirmed."

In U. S. v. **Boss & Peak Automobile Co., 285 Fed. 410 (D.C. Ore.), aff'd 290 Fed. 167 (9th Cir.)**, the government sued C. L. Boss and E. W. A. Peake **as transferees** to recover from them a deficiency in tax asserted against Boss & Peak Automobile Co., a corporation which had been engaged in the automobile business.

Boss contended that the transaction between him and Peak was a **dissolution** of the corporation and distribution of its assets, and hence both were liable in proportion to the amount of the assets they received. **Peak contended** that the transaction was a **sale** of stock by him to Boss; that the consideration for the sale came from Boss and that Peak was not a transferee of assets of the corporation. The trial court held the transaction to be a sale of stock by Boss & Peake and that **Boss alone was the transferee** of the corporate assets which he **used in acquiring Peak's stock,** and that Peak was not a transferee, and rendered judgment against Boss only.

The facts and questions involved are very closely analogous to the case at bar. Boss and Peak each owned one-half of the capital stock of the corporation. They decided to part company and discussed the matter for some months. The negotiations between them were oral and their testimony with respect to the na-

ture of the transaction was diametrically opposed. Boss testified that they discussed dissolution of the corporation and division of the assets and was largely corroborated by the testimony of an employee. Peak testified that in all of their negotiations they discussed merely a sale of the stock by Peak to Boss at a price equal to his one-half interest in the corporation.

The transaction was consummated as follows:

After Boss and Peak came to an oral understanding (but the stock had not been transferred and Peak had not been paid) Boss proceeded to raise the money with which to acquire the stock. He caused a meeting of the stockholders of the corporation to be held at which he treated himself as the owner of all of the stock except two nominal shares. At that meeting, a resolution was adopted for the transfer of all of the assets of the corporation to a partnership composed of Boss and McRell, who had but a nominal interest, and he caused the corporation to execute a bill of sale of the assets to the partnership.

Boss borrowed $8,537.15 from the corporation, giving it his note. This money Boss deposited to his own account. He borrowed $8,000.00 from another source and deposited that in his own account. The partnership borrowed $9,600.00 from Peak, executing the partnership notes to Peak and the notes were secured by conveyance of Hudson automobiles **which the partnership acquired from the corporation.** The partnership gave this money to Boss which was likewise deposited to his bank account, thus making up a total

of $26,137.15 for which amount he drew a check and delivered the same to Peak. At the same time, Peak endorsed and delivered the stock to Boss. This concluded the transaction so far as Boss and Peak were concerned and shortly thereafter Boss caused the corporation to be dissolved.

The trial court said that so far as the evidence of the oral negotiations was concerned, "Standing alone, and according to the witnesses' full credibility, Boss would have the preponderance of the evidence in his favor."

But considering what was actually done, the court held:

> "We have in what took place the **physical facts** which in their evidentiary character are potent and scarcely to be disputed. In short, Boss assembled his funds and placed them in the bank to his credit so that he could draw against them. Thereupon he drew his check to the order of Peak and delivered it to him. At the same time, Peak's stock was assigned in accordance with their understanding and thus the transaction was closed."

Nothwithstanding the fact that **Boss used the assets of the corporation with which to acquire Peak's stock,** the trial court held:

> "Considering all the testimony, and the manner in which the parties have treated the subject-matter of their adjustment, I am impelled to the conclusion that the agreement consisted in the **sale** by Peak of his capital stock in the Boss & Peak Automobile Company to Boss for the lump consideration of $25,000.00, ... and that it was **not for a dissolution of the corporation and a divi-**

sion and distribution of its physical assets between them. As between Boss and Peak, therefore, the former is liable for the entire tax, and the latter should not be held accountable for any of it."

. . . .

"The government bases its remedy against Peake upon the hypothesis that he was a stockholder in the Boss & Peake Automobile Company when and at the time it was dissolved, and that he came into possesison of a portion of its property in the way of distribution sufficient in value to pay the remainder of the tax due, and therefore that he is liable. In other words, it is argued that Boss and Peake received the then existing assets of the corporation, and that it is immaterial to the government as to what form the distribution took, so long as the assets of the corporation were actually depleted by the stockholders, whether Peake received his portion in form as part of the purchase price of his stock or as a distribution of the assets.

"It must be conceded that where, upon the dissolution of a corporation, its assets are distributed among the stockholders, the stockholders become liable to the creditors of the corporation, at least to the extent of the property receiced by them. This is referable to the so-called **trust doctrine.** As we have seen, Peake sold his stock to Boss. Having the stock, the Boss & Peake Automobile Company, through Boss, as president, and McRell, to whom was assigned one share of stock as secretary, by bill of sale, sold and transferred the entire assets of the corporation to the C. L. Boss Automobile Company. The sale was in due time ratified by the stockholders, Boss representing 298 shares of the stock at the time. In all this Peake had no part.

"Availing themselves of the corporation assets, Boss and McRell were enabled to, and did, organize the C. L. Boss Automobile Company, a co-

partnership; Boss giving to McRell such interest only as McRell was able to purchase and pay for. The copartnership having been organized and established as an entity capable of holding the assets of the corporation transferred to it, Boss and McRell were so equipped that they thereupon, through the usual formalities, dissolved the corporation at a time when it possessed no assets for distribution. Again, in neither the formation of the copartnership nor the dissolution of the corporation did Peake have a hand. The logical sequence was that Boss acquired all the assets of the corporation, and utilized them as his capital in the copartnership, and this by reason of the fact that he had acquired Peake's stock. Otherwise, he could not have accomplished his purpose simply because Peake would not have allowed it. Applying the trust doctrine, it would follow that Boss, and not Peake, would be liable for the debts of the corporation, and with them the tax in question. Aside from this, it must be borne in mind that Boss assumed the liabilities, and Peake was to be relieved of them."

. . . .

"It is said that Peake depleted the assets of the corporation, and that for this he is liable. What he did, so far as the record shows, was to loan the C. L. Boss Automobile Company $9,600, and take as security for the payment thereof mortgages on certain cars, which were previously a part of the assets of the corporation. The money was advanced to the copartnership by check, and by it turned over to Boss, who utilized it in paying Peake in part. The copartnership was left, as we have seen, owing Peake the amount of the $9,600. The result was that a part of the previous assets of the corporation, but now the property of the copartnership, was thus incumbered in favor of Peake. Another circumstance is that Boss borrowed $8,537.15 from the corporation on his note, and with this paid Peake, in part, the consideration for which he sold his stock.

"Whether this amounted to a depletion of the assets of the corporation may be questioned, even though the property had not passed to the copartnership. In the one case, the entity had the money, which was a lien upon the cars hypothecated, and in the other it had the note of Boss, the equivalent, supposedly, of the money withdrawn from its coffers. But, however that may be, a mere depletion of assets, unless accompanied by fraud, with the view of overreaching creditors, does not afford basis for an equitable action to recover against the party receiving the assets withdrawn. Dividends are paid out every day, which action in itself is a depletion of assets accumulated; yet no one thinks, when the corporation has gone into liquidation or insolvency, of suing to recover such dividends. So in the present case, unless the supposed depletion is referable to the so-called trust doctrine, which it manifestly is not, the government cannot have remedy on that account. I was impressed at the trial that, Peake having received money, which came from the corporation, sufficient to cover the tax due, he would be rendered liable thereby; but, from the foregoing considerations, obviously this cannot be the rule.

"The government will have a decree against C. L. Boss for the amount of the tax due, with interest and penalty. The bill of complaint will be dismissed as to E. W. A. Peake, and the cross-bill of Boss and Peake Automobile Company and C. L. Boss against Peake will also be dismissed, with costs to Peake against Boss."

On appeal this court, among other things, held:

"We might content ourselves with the mere statement that this finding, based as it is on conflicting testimony taken in open court, should not be disturbed on appeal. But an independent review of the testimony leads to the same conclusion. . . . . . . **No doubt a dissolution was contemplated at least as early as June 1st, and probably Peak**

had notice of that intention. But why should that concern him? As soon as he had disposed of his stock, the fate of the corporation rested in other hands, and he was thereafter powerless to insist upon a dissolution even if he so desired.

"The fact that the selling price of the stock was fixed at approximately half the value of the assets of the corporation is of little significance, in view of the fact that each party owned half of the stock. . . . . . On the entire record we are satisfied that the present claim that there was a dissolution of the corporation and a division and distribution of its assets among stockholders on June 1st is a mere after-thought, to escape liability for the tax. So far as the record discloses, there was then no reason why there should be a dissolution of the corporation, or a division and distribution of its assets, rather than a transfer and sale of the Peak stock, or why the transaction should assume one form rather than the other. There was a transfer of stock in form at least, and we are satisfied there was a transfer in fact and in law." . . . .

"There is no error in the record, and the decree is therefore affirmed."

In **Terrace Corporation v. Commissioners, 37 B.T.A.** 263, the transfer of assets was made July, 1933, a warrant of distraint was issued, and returned nulla bona in March, 1934—some nine months later, and the transferee liability was asserted at that time. It was stipulated that the transferor was insolvent from and after the assessment of the dificiencies. The **record did not show whether the taxpayer was solvent or insolvent at the time of the transfer of assets.** The Board held:

"If petitioner is correct in point 1, then we need go no further. One of the essential things which

the Commissioner must prove to fix transferee liability in equity upon a transferee of assets is that the **transfer** was either **made while** the **transferor was insolvent** or else **resulted in insolvency** of the transferor, or, in the case of a corporation, was one of a series of distributions in liquidation which resulted in its insolvency.

. . . .

"There can be no question but that if Aycock was insolvent at the time the transfer in question was made to petitioner, Terrace Corporation, or if such tranfer rendered him insolvent, such transfer was a fraud upon his creditors and the Government would have a right to proceed against petitioner as a transferee. An **insolvent** debtor cannot make an effective transfer as against his creditors of his property to a corporation which he forms, in exchange for its capital stock (and for the purposes of his discussion we will treat all of the stock of petitioner as having been issued to Aycock or his nominees). First National Bank of Chicago v. Trobein Co., 59 Ohio St. 316; Allen v. French, 178 Mass. 539. It seems **equally well settled** that a **solvent individual** who is not rendered **insolvent** thereby, **may freely convey his property** to whomever he pleases, no actual fraud being shown.

. . . .

"Petitioner concedes that the stipulated facts show that Aycock was insolvent from and after the assessment of deficiencies against him in March, 1934, but contends that these facts fall short of showing that Aycock was insolvent on July 12, 1933.

"In this contention we think **petitioner must be sustained**. It may well be that respondent could have proved that the transfer which Aycock and his wife made to petitioner on July 2, 1933, was made while he was insolvent or that the transfer itself rendered him insolvent, but he did not prove

it and we know of no authority for us to supply by inference what respondent has failed to prove. The statute places the burden of proof to show transferee liability upon respondent and that means that he must prove all elements which are necessary to make out a prima facie case. He has not made out in the instant case such a prima facie case and there is no obligation upon the transferee to go forward with his defense until respondent has done so.

"It is undoubtedly true that if respondent had proved that Aycock was insolvent at the time he and his wife made their conveyance of the homestead property to petitioner, or immediately thereafter, the petitioner would not be heard to claim that it was an innocent purchaser for value. The rights of an innocent purchaser for value would not be a valid defense available to petitioner, a transferee corporation, under such circumstances. Clark v. Walter T. Bradley Coal Co., 6 App. D.C. 437; Roberts v. Hughes, 86 Vt. 76; 83 Atl. 807.

"But, as we have already pointed out, a transferee does not have to enter upon his defenses until the complaining creditor has made out a prima facie case, and the trouble in the instant case is that respondent has not proved that Aycock was **insolvent** when he made the transfer nor has he proved that such conveyance resulted in Aycock's insolvency. What respondent has proved is that Aycock was insolvent seven or eight months afterwards, at the time the deficiencies were assessed against him in March 1934, and has continued so thereafter. It is true that the stipulation shows that the Commissioner has issued a warrant of distraint against Aycock and has found no property.

"This is equivalent to a return of an execution nulla bona against the debtor and is sufficient to prove that the creditor has exhausted his remedies against the debtor transferor (one of the neces-

say elements to prove in establishing transferee liability in equity), but the weight of authority seems to hold that the return of an execution nulla bona against the debtor, several months after the alleged fraudulent transfer, is not sufficient to prove that the debtor was insolvent at the time of the transfer or was rendered insolvent thereby. Cf. American Feature Film Co., 24 B.T.A. 18."

"In this latter case the facts showed that the taxes against the taxpayer transferor had not been paid and that distraint warrants had been issued against him and returned nulla bona. Nevertheless we said, '**These facts** do **not prove insolvency immediately** after **the alleged distribution** (citing cases).

. . . .

"It should be kept in mind that in a transferee proceeding insolvency must be proved **at two basic dates: (1) at the time of the transfer of the property; (2) at the time the creditor brings his action to subject the property in the hands of the transferee to the payment of his claim**. The first is necessary in order to show that the conveyance was a fraud on the transferor's creditors. The second is necessary in order to show that the primary debtor is unable to respond to the creditor's demand and therefore a resort to a secondary liability is justified.

In **Wire Wheel Corporation of America v. Commissioner, 16 B.T.A. 737, 741—aff'd 46 Fed. (2d) 1013,** the court held:

"The Federal courts also require that the remedies against a transferor be exhausted to no avail before proceedings can be initiated against a transferee . See Swan Land & Cattle Co. v. Frank, 148 U.S. 603, which decision was cited in the report of the Senate Finance Committee (p. 29) on section 280 of the Revenue Act of 1926. In Pierce

v. United States, 255 U.S. 398, the court said:

> 'A judgment creditor's bill is in essence an equitable execution comparable to proceedings supplementary to execution. See Ex parte Boyd, 105 U.S. 647.
>
> . . . .
>
> It is true that the bill to reach and apply the assets distributed among the stockholders cannot, as a matter of equity jurisdiction and procedure, be filed until the claim has been reduced to judgment and the execution thereon has been returned unsatisfied, Hollins v. Brierfield Coal & Iron Co., 150 U.S. 371.'

"Thus it seems clear that were it not for section 280 the respondent could not have proceeded against petitioner in equity under the **trust fund** theory until he had exhausted available remedies against the Houk Company. It seems equally clear that he has not exhausted such remedies. . . . . .

. . . .

"Respecting this section we quote from the Senate Finance Committee's report, pp. 29 and 30.

> 'It is the purpose of the committee's amendment to provide for the enforcement of such liability to the Government by the procedure provided in the act for the enforcement of tax deficienies. It is not proposed, however, to define or change existing liability. The section merely provides that if the liability of the transferee exists under other law then that liability is to be enforced according to "the new procedure applicable to tax deficiencies."'

"Manifestly this section was designed only to allow, and does only allow, the respondent an additional means of procedure against a transferee **only if available remedies against a transferor would be unavailing**. The same conditions precedent must be met in such a proceeding, however,

as must be met before an action in equity to enforce the same liability. No new liability is created and the act does not purport to provide for a proceeding against the transferee before action would otherwise lie against such transferee. On the record before us, it is apparent that the **respondent is attempting a short cut not contemplated by the statute.** Since there is no liability, judgment must be entered for the petitioner."

Commissioner of Internal Revenue v. Oswego Falls Corporation, 71 Fed. (2d) 673 (2d Cir.):

"The **remedy** afforded by section 280 of the Revenue Act of 1926 is **nonexistent until all the remedies against the taxpayer are exhausted.** Wire Wheel Corp. of America v. Com'r, 16 B.T.A. 737; Id. 46 F. (2d) 1013 (C.C.A. 2d). This section makes the executive processes available to determine and collect the liability of a transferee of property in respect of taxes incurred by his transferor, but it does not impose any new liability. Phillips v. Com'r, 283 U.S. 539.

. . . .

"Moreover, **no liability** arises to the taxpayers as transferee **until** the creditors' **rights** preserved to the Commissioner by section 11 of the Business Corporation Law have been **exhausted.** Wire Wheel Corp. of America v. Com'r, supra. The liability and corresponding right existing prior to the consolidation were expressly preserved and unimpaired by the statute. The **remedy** which the Commissioner has **chosen** is **conditioned** on the **exhaustion** of the **remedy he** sets **aside.** . . .

"The liability of a transferee, on the debt of his transferor, arises only upon exhaustion of remedies."

In **Terrace Corp. v. Commissioner, 37 B.T.A. 263,** the Board held that exhaustion of remedies against the

taxpayer is

> **"one of the necessary elements to prove in establishing transferee liability . . ."**

In **Gleichman v. Commissioner, 17 B.T.A. 147,** the Board held:

> "Before proceedings may be brought against a transferee the law requires that the **remedies** against the transferor **must have been exhausted** to no avail. Swan Land & Cattle Co. v. Frank, 148 U.S. 603, which decision was cited in the report of the **Senate Finance Committee** (p. 29) on section 280 of the Revenue Act of 1926. The Supreme Court said in Pierce v. United States, 255 U.S. 398:
>
> > 'It is true that the bill to reach and apply the assets distributed among the stockholders cannot, as a matter of equity jurisdiction and procedure, be filed until the claim has been reduced to judgment and the **execution thereon** has been returned unsatisfied, Hollins v. Brierfield Coal & Iron Co., 150 U.S. 371."
>
> "Except for **Section 280,** the respondent **could not have proceeded** against the petitioner **until he had exhausted available remedies** against the theatre company. We think he has not exhausted **such remedies.** The theatre company is, so far as the record shows, still in existence. A revenue agent testified that he examined the theatre company's books and investigated its ability to pay in 1924 and determined that there was nothing against which satisfaction could be obtained. The transferee liability was not asserted until May, 1926. There is nothing in the record to show the financial condition of the theatre company at that time.
>
> "Section 280 creates no new liability, but only allows the respondent an additional means of pro-

ceeding against a transferee when such transferee would be liable at law or in equity. The respondent has failed to establish any liability on the part of petitioner as a transferee of assets of the Broadway-Strand Theatre Co."

In **Annie Troll v. Commissioner, 33 B.T.A. 598, 602,** the Board held:

"Upon the foregoing facts, which we find, we are called upon to determine the liability of petitioner as transferee. The burden of proof is upon the respondent to show that petitioner is liable as a transferee. Title IX of the Revenue Act of 1924, as amended by section 602 of the Revenue Act of 1928. This burden includes the burden of showing that the transfer of the assets to the transferee rendered the transferor insolvent, or that the transferor was insolvent at the time of the transfer. (Cases) . . . In Florence McCall, supra, we stated in part:

'We have held that the statute places a **real burden** of proof on the respondent and that he must establish the liability of the transferee against whom he proposes to proceed. Eliza J. Wray, 24 B.T.A. 94; Annie Temoyan et al., 16 B.T.A. 923. . . . .

. . . .

"Richard Wunsch, deputy collector, testified that at the time he filed the notices of tax lien on July 2 and 3, 1930, he made efforts to locate some assets of Charles Troll, but that he was unsuccessful It is to be noted that the testimony of this witness is not directed toward proving what assets or liabilities Charles Troll had at the date in question, the controlling date, March 1, 1930, but to days more than four months later, and therefore, it is not sufficient to prove insolvency on March 1, 1930, the date of the transfers in question here. Even when considered as having some bearing up-

on the financial condition of Charles Troll at March 1, 1930, it is insufficient to establish that Charles Troll was insolvent at the date in question. He **did** not **testify** in detail **as to the efforts** he **made** to **locate assets** of the transferor and we cannot, in the exercise of our independent judgment, determine from his testimony that Charles Troll did not have other assets or was insolvent. **It is significant** that he **did not return any warrant** of **distraint nulla bona** or make **any return whatsoever** upon any **warrant** of distraint in **the form provided thereon for the purpose** or in any other form. The form of return and accompanying instructions provided on each such warrant required a thorough search and a full report, in the form of a certificate, of the result over the signature of the deputy collector supported by his affidavit in the event of a 'report of no property found liable to distraint'. His **conduct is open to the inference that he was not in a position as a matter of fact to make such return.** For all we know from the evidence adduced, Charles Troll **may have** had **other assets** on March 1, 1930, of a value **sufficient** to cover **all of his liabilities.**

"It is also important to note that the space on the reverse side provided for the return of the deputy collector in each of the warrants for distraint against Charles Troll is wholly blank, there being no return made as to any of the warrants; and we are therefore not called upon to decide, and do not decide, whether such returns, if they had properly shown that no assets could be found, would have been favored with a presumption of correctness as to the financial condition of the transferor as of the date of the transfers or otherwise. . . . .

"It may not be amiss to point out that in Hatch v. Morocco Holding Co., supra, (50 Fed. (2d) 138), the court stated:

'Ordinarily a creditor must proceed to judg-

ment against his debtor and have an execution returned nulla bona before he can pursue third persons on his claim (Citing cases.) * * * But, where the debt is admitted (citing cases), and it is apparent that a judgment and execution against the debtor would be futile (citing authority) the procedural requirement may be dispensed with.'

"Here it is not apparent that Charles Troll was insolvent and that it would have been futile to proceed against him; and we must hold that respondent has not met the burden of proof in this respect. . . . . ."

In **Florence McCall v. Commisisoner, 26 B.T.A. 292,** it was said:

"We have held that the statute places real burden of proof on the respondent and that he must establish the liability of the transferee against whom he proposes to proceed."

. . . .

"It has been held that before proceedings may be brought against a transferee it must appear that the remedies against the transferor would be of no avail. Swan Land and Cattle Co. v. Frank, 148 U.S. 603; Phil Gleichman, 17 B.T.A. 1470. It does not appear in these proceedings that such is the case. It is our opinion that the contrary appears.

. . . .

"The respondent made no attempt between April 6, 1927 and January, 1930 to enforce either in law or in equity any liability against the estate of Mahlon or the executors thereof (W. Newton) although it is apparent from the facts that the fund hereinbefore referred to could have been reached by execution at and prior to the date of the attempted assertion of the transferee liability.

. . . .

"It follows from the foregoing that the petitioners herein are not liable as transferees."

In 26 R.C.L. 1185, **Section 21**, the law is stated as follows:

"**Conversion of Imperfect Gift into Trust.**—It is a well established rule that where an intended gift is incomplete or imperfect because of lack of delivery or other cause, and there is insufficient evidence to establish a trust, the courts will not, on account of such imperfection, convert the imperfect gift into a declaration of trust in order to effect the intention of the donor. . . . . . . There is no principle of equity which will perfect an imperfect gift, and a court of equity will not impute a trust where a trust was not in contemplation. And where an intention to give absolutely is evidenced by a writing which fails because of its non-delivery, the court will not and cannot give effect to an intended absolute gift by construing it to be a declaration of trust, and valid, therefore, without delivery. There is now **no distinction between the case of an intended gift from husband to wife, and that of a gift from him to a stranger,** though formerly in England when a gift by a husband to his wife was not permitted it was held that such a transaction could be supported as a trust."

12 R.C.L. 951, Section 26:

"**Imperfect Gift.**— . . . . Equity will not impute a trust where none was in contemplation, and an imperfect gift will not be given effect by construing it as a declaration of trust and therefore valid without delivery, even in case of a charity, though where a voluntary trust upon a meritorious consideration has been perfectly created, it may be enforced in equity."

In **Morsman vs. Commissioner, 90 Fed. (2d) 18** (8th Cir.), the Court held:

> "Trusts, Restatement, Section 26, Comment **a**, states the rule thus,
>
> "If a person declares his intention or promises that he will at a subsequent time transfer property then owned or thereafter to be acquired by him to another person in trust no trust arises unless and until he makes the transfer in trust.
>
> "Further, the declaration of an intent, unsupported by consideration, to hold and preserve one's own property for the eventual enjoyment of another is no more than a declaration of a purpose to make a gift, and in this case it is ineffective as such for lack of delivery. **Farmers Loan & Trust Co. v. Winthrop, supra.** The intent that the property was to be turned over to the trustee does not, therefore, amount to a declaration of trust because that intent had not been carried out at the time of the transactions under consideration. 'A declaration (of trust) implies an announcement of an act performed, not a mere intention. * * *'. **In re Brown's Will, supra.** To the same effect see Trusts, Restatement, Section 23."

In **Harvard vs. Commissioner, 26 B.T.A. 1161,** the Board held:

> "Upon the record it is perfectly clear that the petitioners surrendered their stock and received payment therefor in the checks of the taxpayer about June 1, 1924, in the amounts set forth in our findings of fact. **The record does not support a finding of fact that the taxpayer was liquidating its business at June 1, 1924.** The only corporate action relating in any way thereto was the resolution of the stockholders on December 31, 1924, authorizing the sale of the corporate assets, but that resolution is silent as to the disposition to be

made of the proceeds of such sale. The **certificates** for which the petitioners were paid were **not cancelled,** but were taken into the accounts of the taxpayer as treasury stock and later reissued to W. E. Corn. After the petitioners and several other stockholders had turned in their certificates and received payment therefor, the **taxpayer continued in the business of manufacturing ice and selling coal for more than a year.** The first corporate action looking to the closing out of the business was a resolution adopted on October 28, 1925, and the application for dissolution which was filed on June 28, 1926. Even then there is no statement to show whether the assets of the corporation had been distributed prior to the resolution authorizing dissolution or were to be distributed by the statutory trustees thereafter."

In **Ross v. Commissioner, 43 B.T.A. 1155,** the Board held:

"With respect to the argument advanced, it is necessary only to say that for the purpose of deciding this issue it matters not whether the respondent was of the view that the four individuals were the actual owners of the stock of the corporation in the proportions on which the profits were distributed, or whether he was of the view that the stock was owned 598 shares by Ross and one share each by Pershall and Hicks, as the stock account indicates, and that the 'considered' ownership of the stock by the four individuals was for the purpose only of computing the distributive share of the profits under a profit-sharing arrangement with Pershall, Jameson, and Hicks in return for the services which they were to render the corporation. **The controlling fact here is that the assets of the corporation after the transfer of its business and facilities to the partnership amounted to $60,000 and this amount was distributed to the stockholders of record, $59,800 being paid to**

Ross and $100 each to Hicks and Pershall, leaving the corporation without assets. These facts bring the petitioner W. R. Ross within the transferee provisions of the statute and **to the extent of such distribution he is liable as transferee."**